Supreme Court, U.S.
FILED
'93 1132 JAN 10 1994

No. 93-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

REUTERS LIMITED,

Petitioner,

vs.

TAX APPEALS TRIBUNAL and
COMMISSIONER OF TAXATION AND FINANCE,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEALS OF THE STATE OF NEW YORK

PETITION FOR A WRIT OF CERTIORARI

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Dated: January 10, 1994

100 pp

QUESTIONS PRESENTED

1. Whether New York's use of the allocated worldwide income of an alien corporation, doing business in New York through a branch, as the basis for calculating the corporation's corporate franchise (income) tax violates the non-discrimination provision of the United States-United Kingdom Tax Treaty when it results in a tax on the alien corporation less favorable than the tax imposed on a domestic corporation "carrying on the same activities" as the branch.

2. Whether New York's use of the allocated worldwide income of an alien corporation, doing business in New York through a branch, as the basis for calculating the corporation's corporate franchise tax violates the United States-United Kingdom Tax Treaty or the Foreign Commerce Clause of the United States Constitution when it imposes onerous and discriminatory compliance burdens on the alien corporation.

3. Whether New York's taxation scheme, which facially discriminates against foreign source income, violates the Foreign Commerce Clause of the United States Constitution.

PARTIES TO THE PROCEEDINGS BELOW AND RULE 29.1 LIST

The parties to the proceedings below were:

Reuters Limited*
The Commissioner of Taxation and Finance
The Tax Appeals Tribunal of the State of New York.

* The parent company of petitioner Reuters Limited is Reuters Holdings PLC. Subsidiaries or companies in which Reuters Limited owns a significant interest (other than wholly owned subsidiaries) are Rich, Inc., Instinet Corporation, Reuters Information Technology Inc., Reuters Futures Services Inc., and American Real Time Services Inc.

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PETITION FOR A WRIT OF CERTIORARI TO THE
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PETITION FOR A WRIT OF CERTIORARI

Reuters Limited ("Reuters"), a United Kingdom company, petitions for a writ of certiorari to review the judgment of the Court of Appeals of the State of New York.

OPINIONS BELOW

The opinion and order of the Court of Appeals of the State of New York is reported at 82 N.Y.2d 112, and is reprinted in the Appendix hereto at 1a-10a.[1] The order of the Court of Appeals granting Reuters motion for leave to appeal is reported at 81 N.Y.2d 704, and is reprinted in the Appendix hereto at 11a. The opinion of the Supreme Court, Appellate Division, Third Department is reported at 180 A.D.2d 270, and is reprinted in the Appendix at 12a-17a. The decision of the Tax Appeals

[1] References to the Appendices to this Petition are cited herein as "___a."

Tribunal of the State of New York is reported at 1991 N.Y. Tax LEXIS 144, and is reprinted in the Appendix at 18a-34a. The determination of the Division of Tax Appeals of the State of New York is reported at 1990 N.Y. Tax LEXIS 87, and is reprinted in the Appendix at 35a-56a.

JURISDICTION

The opinion of the New York Court of Appeals was entered on October 12, 1993. (2a.) The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND TREATY PROVISIONS INVOLVED

Article I, Section 8, clause 3 of the United States Constitution provides in pertinent part:

> The Congress shall have the Power . . . To regulate Commerce with foreign Nations . . . .

Article 24(2) of the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, U.S.-U.K., 31 U.S.T. 5668 (the "Treaty"), provides:

> The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.

STATEMENT OF THE CASE

This case presents a question of national and international significance concerning the proper interpretation of the standard nondiscrimination provision contained in tax treaties between the United States and virtually all its major trading partners. The decision of the New York Court of Appeals is directly contrary to the text of the nondiscrimination provision and to every known interpretation of that provision. The decision below requires Reuters to pay a New York income tax based on its

worldwide income, although Reuters[2] New York branch operated at a loss, and although a New York corporation carrying on the same activities as the branch and operating at a loss would owe no New York tax.[3] It is precisely this discrimination between local and foreign corporations that Article 24(2) – the nondiscrimination provision – of the Treaty[4] is intended to prevent. In addition, the New York tax scheme imposes prohibitive compliance burdens on Reuters and facially discriminates against foreign source income, which raises important issues under Article 24(2) of the Treaty and the Foreign Commerce Clause. *See, e.g., Barclays Bank PLC* v. *Franchise Tax Board, pet. for cert. granted,* ____U.S.____, 114 S. Ct. 379 (1993) ("*Barclays*"); *Kraft General Foods, Inc.* v. *Iowa Dept. of Revenue and Finance,* ____U.S.____, 112 S. Ct. 2365 (1992).

1. Reuters is a corporation organized and existing pursuant to the laws of England. Reuters business is to supply news and economic and financial information to newspapers, banks, insurance companies and others interested in such information. (36a.) Reuters operates throughout the world and, during the years at issue here, Reuters did business through branches in approximately 80 countries. (36a.)

All of Reuters news and financial information activities in New York – and in the United States – were carried out by its New York branch during the three years in issue – 1977, 1978 and 1979. (36a.) The gross revenues flowing from the activities carried on by Reuters New York branch represented a maximum of fifteen percent of Reuters worldwide gross revenues for the years in question. (37a.) It is undisputed that the

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[2] As a matter of style, Reuters does not use the possessive form – Reuters' – even where convention would use that form.

[3] Reuters does not argue that the formula apportionment method is *per se* prohibited by the Treaty, but only that this method cannot be applied when it results, as here, in discriminatory taxation.

[4] The Treaty was ratified and entered into force in 1980. However, by its terms, the Treaty is retroactively effective to 1975. *See* Treaty, Art. 28, 31 U.S.T. at 5689. The prior U.S.-U.K. treaty was virtually identical in all relevant respects.

activities of Reuters New York branch make that branch a "permanent establishment" within the meaning of the Treaty. (36a.)[5]

For each of the three years in issue, Reuters filed federal income tax returns as a foreign corporation with the United States Internal Revenue Service. Reuters also filed tax returns as a resident of the United Kingdom ("U.K."), where it is subject to taxes on its worldwide income. (37a.) Under federal law, Reuters filings with the IRS were computed solely on the basis of income attributable to Reuters activities in the United States – the activities of its New York branch. (36a-37a.) For each of the years at issue, Reuters had a net loss for federal tax purposes and, therefore, paid no federal income tax. (37a.)[6]

2. Reuters also filed corporation franchise (income) tax returns under Article 9-A of the New York Tax Law with the State of New York. The tax is calculated on the basis of a corporation's "entire net income," which is defined as "total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department." N.Y. Tax Law § 208(9) (McKinney's 1986). Entire net income includes "income within and without the United States." *Id.* § 208(9)(c). For an "alien corporation" – that is, "[a] corporation organized under the laws of a country other than the United States which has income from sources outside the United States," 20 NYCRR § 3-8.3 (1984) – the basis upon which the New York franchise tax is calculated includes worldwide income. Such a corporation must add back to its New York income "all income from sources outside the United States . . . which was not taken into account in computing federal taxable income." 20 NYCRR § 3-2.3(a)(9) (1984).

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[5] A "permanent establishment" is a branch of a foreign company whose business activities are sufficient to entitle the host jurisdiction to impose income taxes upon it. *See* Treaty, Art. 5, 31 U.S.T. at 5674.

[6] This treatment by the federal government is consistent with the international norm, which is to tax a foreign company only on the basis of income earned within the taxing country's borders. The U.K. also follows this international norm. Thus, New York companies doing business in the U.K. (*i.e.*, the reverse of this case), are taxed *only* on the income earned within the U.K. Record on Appeal, submitted in the New York Court of Appeals, at 146 (hereinafter "R. at ____").

When a foreign corporation does business both in New York and elsewhere, New York allocates a portion of its entire worldwide net income to the State according to a three-factor test, in which the value of property, payroll and receipts in New York is compared to the worldwide value of these factors to produce a ratio known as a "business allocation percentage." N.Y. Tax Law § 210(3). The corporation's worldwide entire net income is then multiplied by this percentage to produce the portion of income allocated to the State. *Id.* The franchise tax is a defined percentage of this allocated income. *Id.* § 210(1)(a).

Because Reuters did not have — and could not reasonably obtain — worldwide financial information that complied with New York's tax laws, and because Reuters believed that the application to it of New York's worldwide allocation method violated the Treaty and the Constitution, Reuters filed its 1978 and 1979 franchise tax reports computed solely on the basis of the activities of its New York branch, as it had done with its federal returns, which included all effectively connected United States income. Reuters initial 1977 New York State return facially allocated a portion of worldwide income to New York. However, that worldwide income was derived from financial records that did not comply with the New York State Tax Department's rules for calculating taxable income. Reuters amended its 1977 filing in 1981, and computed its state tax liability solely on the basis of income derived from the activities of its New York branch, as it had previously done for its 1978 and 1979 returns. (R. at 247-54.)

3. Between September 1980 and September 1983, the New York State Division of Taxation conducted an audit covering the three returns at issue. The Division recomputed Reuters New York branch's net income for each of the three years in question based on an allocation of the income generated by the approximately 80 worldwide branches of Reuters. On October 14, 1983, the Division issued to Reuters three notices of deficiency that set forth a total deficiency of $1,280,100. (38a.) The bulk of this assessment was based upon two blatant computational errors in the application of New York's allocation formula.[7] These

[7] These computational errors were not at issue in the proceedings below and are not at issue here.

errors were compounded by the Tax Department's reliance on information published in Reuters annual reports. (R. at 279-80.) That information was in pounds sterling and was prepared in accordance with U.K. Generally Accepted Accounting Principles (GAAP) — *not* in accordance with New York's very different tax accounting standards. (R. at 130.)

Following a conference, Reuters submitted information correcting the two blatant computational errors. However, the figures Reuters supplied, like those used by the Tax Department, were based upon the non-complying U.K. accounting figures contained in Reuters annual reports. (39a.) Reuters simply did not have worldwide information prepared in accordance with New York tax accounting standards. The Tax Department chose to accept the non-complying U.K. GAAP figures, recomputed the deficiency for the three years in question, and assessed a total deficiency of $96,168. (22a.)

The unrefuted record evidence establishes that it would cost approximately $1,000,000 each year (as computed in 1988 in 1988 dollars) for Reuters accurately to calculate its income in the manner required by the New York Franchise Tax Regulations. (23a.) No comparable burden would be borne by a New York corporation conducting the same business as Reuters U.S. permanent establishment. Moreover, such burdens are *not* necessary to prepare Reuters federal U.S. tax return because the U.S. government does not tax income earned by Reuters branches in other countries. Thus, for the years in issue, the cost of calculating the deductions attributable to Reuters gross income earned by its foreign branches would far exceed the tax saving resulting from those deductions. Failure to claim the deductions, however, would result in Reuters paying more in New York taxes than would a U.S. company having New York income and deductions identical to those of Reuters. (R. at 138-40.)

4. Reuters timely filed a petition with the New York State Tax Commission on January 10, 1984, challenging the deficiency on the grounds that New York's taxation based on Reuters worldwide income violated both the Treaty's nondiscrimination provision as applied to Reuters and the Foreign Commerce

Clause of the United States Constitution by imposing unreasonable compliance costs and because the tax prevented federal uniformity in this important area. (R. at 189.) On February 22, 1990, the administrative law judge issued a decision rejecting Reuters Treaty and Foreign Commerce Clause challenges (55a), denying Reuters petition, and sustaining the three notices of deficiency (55a-56a), as modified, for $96,168. (38a.)[8]

Reuters timely filed an exception to the administrative law judge's determination on March 19, 1990, and raised the same Treaty and Foreign Commerce Clause challenges. (R. at 78.) On March 21, 1991, the New York State Tax Appeals Tribunal ("Tribunal") entered a decision and order affirming the determination of the administrative law judge. (18a.) The Tribunal recognized that Article 24(2) of the Treaty did apply to New York State taxes (29a), but rejected Reuters contentions that New York's use of Reuters worldwide income to calculate the State's franchise tax violated both the Treaty and the Foreign Commerce Clause of the federal Constitution. (28a-34a.)

On July 19, 1991, Reuters commenced a special proceeding by petition in the Appellate Division – Third Department, seeking review of the decision of the Tribunal and again raising the Treaty and Foreign Commerce Clause issues. (R. at 7.) On June 11, 1992, that court rejected Reuters' Treaty and Foreign Commerce Clause challenges (15a), confirmed the determination of the Tribunal, and dismissed the petition. (17a.)

5. By order dated and entered February 11, 1993, the Court of Appeals granted Reuters Motion for Leave to Appeal (11a).[9]

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[8] The administrative law judge mistakenly concluded that Article 24(2) of the Treaty did not even apply to a political subdivision of the United States, such as the State of New York. (52a, 28a-29a.)

[9] Reuters filed a Notice of Appeal as of Right on July 15, 1992. By letter dated July 23, 1992, the New York Court of Appeals inquired *sua sponte* into the basis for Reuters appeal as of right. On October 27, 1992, the Court of Appeals dismissed, *sua sponte*, Reuters appeal as of right. 80 N.Y.2d 971.

It issued its Opinion rejecting Reuters Treaty and Foreign Commerce Clause arguments and affirming the decision of the Appellate Division on October 12, 1993. (2a-10a.)

The Court of Appeals found the language of Article 24(2) of the Treaty to be ambiguous, particularly the phrase "carrying on the same activities," with respect to the appropriate domestic subject of comparison for assessing discrimination. (5a.) The court rejected Reuters position that the appropriate comparison was between Reuters New York branch and a New York corporation carrying on the same activities as that branch. *Id.* Instead, the court held that, because Reuters New York branch has no independent corporate or jural identity, the appropriate comparison was between the Reuters worldwide corporate entity and a United States corporation with a branch in New York carrying on the same worldwide activities as Reuters. (5a-7a.) Implicit in the court's holding, and explicit in the decision of the Appellate Division, is that if Reuters had separately incorporated its New York branch, that subsidiary corporation would owe no franchise tax. (15a.) The court further relied on the legislative history of unratified Article 9(4) of the Treaty, which would have prohibited worldwide unitary taxation,[10] as evidence that New York could tax Reuters on its worldwide income. (7a-9a.)

The court rejected Reuters Foreign Commerce Clause argument, relying primarily on *Bass, Ratcliff & Grettan, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924), in which this Court rejected a Foreign Commerce Clause challenge to the *per se* validity of New York's apportionment methodology. Reuters, however, did not challenge the formula apportionment method of taxation as *per se* unconstitutional. Rather, Reuters argued that, pursuant to *Kraft*, *supra*, the method by which "entire net income" is computed under New York law clearly discriminates

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[10] Under worldwide unitary taxation (also known as worldwide combined reporting), a taxpayer aggregates the income of all of the entities that comprise its unitary business throughout the world and apportions a share of the total to the state under a property, payroll and sales formula. The constitutional validity of this system of taxation, as applied to a foreign taxpayer, is currently before this Court. *Barclays*, *supra*.

against foreign source income.[11] The Court of Appeals simply ignored Reuters arguments as they related to *Kraft*.

The court also rejected Reuters uncontroverted evidence that its projected annual compliance costs of approximately $1,000,000 imposes unconstitutionally discriminatory compliance costs on foreign commerce and violates Article 24(2) of the Treaty. (9a.) Instead, the court relied upon the Appellate Division's rejection of this challenge "for failure of sufficient factual showing." *Id.*; (16a). The Appellate Division, however, improperly relied upon Reuters ability to submit *noncomplying* information to reduce its original assessed deficiency based on blatant computational errors; it did not find that Reuters could quickly and easily produce the *required* information in compliance with New York's tax laws.

REASONS FOR GRANTING THE PETITION

This case merits review because the Court of Appeals' decision is flatly contrary to the text of the Treaty, interpretations of the Treaty by the governments of the United States and the United Kingdom, and all known interpretations of identical tax treaty provisions by other courts and commentators. The Court of Appeals' aberrant holding threatens to disrupt the orderly administration of international tax law, an area of great importance to the United States and its major trading partners. This decision calls for this Court's intervention to settle this important federal issue of international tax treaty law.[12]

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[11] Because *Kraft* was handed down after the Appellate Division's decision, Reuters had not previously made the precise facial Foreign Commerce Clause challenge presented to the Court of Appeals. However, as noted, Reuters had repeatedly pressed a Foreign Commerce Clause challenge to New York's taxation scheme at all stages of this case.

[12] Important questions as to the interpretation of United States treaties may give rise to a review on certiorari. *See* Robert L. Stern *et al.*, *Supreme Court Practice* 215 n.54 (6th ed. 1986). In *Kolovrat* v. *Oregon*, 366 U.S. 187 (1961), for example, the Court granted certiorari "because the cases involve important rights asserted in reliance upon federal treaty obligations." *Id.* at 191; *see also Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 176, 177-78 (1982) (certiorari granted to determine whether U.S.-Japan treaty provides a defense under a suit for employment discrimination).

In order to promote international economic competition and access to local markets, the United States and other nations, including virtually all its major trading partners, have agreed, by treaty, to fair limits on the taxation of foreign taxpayers. The United States and its treaty partners – including the United Kingdom – have agreed that it is unfair for a state to impose a greater tax burden on a foreign taxpayer than on domestic competitors engaged in the same – and only the same – activities. The imposition of such a discriminatory burden puts the foreign taxpayer at a competitive disadvantage in the local marketplace, an evil that U.S. tax treaties – including the U.S.-U.K. Treaty – are designed to prevent.

According to all known interpretations of this and other identical treaty provisions, in order to determine whether a tax on a foreign taxpayer is discriminatory, the Treaty requires that the foreign taxpayer's local branch – its "permanent establishment" – be viewed as a separate entity. The "test" is whether the tax on the permanent establishment is greater than that which would be paid by a domestic competitor engaged in the same activities in the same market as the permanent establishment. If it is, then the Treaty's ban against discrimination has been violated.

A New York competitor that lost money while engaged in the same activities as Reuters New York branch would not pay *any* New York income taxes. Thus, the tax imposed on Reuters clearly fails the Treaty's test for nondiscrimination. The Court of Appeals held that this disturbingly unequal treatment of Reuters was permitted by the Treaty because it found that the "test" for nondiscrimination is to compare the tax burden on a global or corporate entity basis. This unprecedented comparison not only ignores the Treaty's plain language, but also undermines its purpose – to protect foreign companies from being taxed out of local markets by local taxing authorities. The Court of Appeals' rewriting of the model nondiscrimination language of international tax treaties raises an issue of both national and international significance.

Moreover, because taxation of Reuters worldwide operations by New York would require it to maintain accounting records

for approximately 80 other countries in accordance with New York law, at a cost of more than $1,000,000 annually, the burden of compliance placed on Reuters is grossly disproportionate – and an unfairly discriminatory penalty under both Article 24(2) of the Treaty and the Foreign Commerce Clause – when compared to the burden on a New York company.

The tax on Reuters New York branch also facially violates the Foreign Commerce Clause of the United States Constitution, in the same way as did the Iowa tax at issue in *Kraft*. That clause prohibits a state from discriminating against income earned from foreign sources in favor of income from domestic sources. Here, the state regulation that is the basis for the state's taxation of Reuters foreign income, by its express terms, discriminates against foreign source income and is thus unconstitutional.

I. THE COURT OF APPEALS' DECISION IS CONTRARY TO THE TREATY'S LANGUAGE, ITS INTERPRETATION BY THE PARTIES, AND THE INTERPRETATION OF IDENTICAL TREATY PROVISIONS BY COURTS IN OTHER COUNTRIES

By treaties, the United States and other nations have agreed to fair limits on the taxation of foreign taxpayers. These tax treaties – including the U.S.-U.K. Treaty at issue here – are binding on the states. U.S. Const. Art. VI; *see Scandinavian Airlines System Inc.* v. *County of Los Angeles*, 56 Cal. 2d 11, 37 (1961), *cert. denied*, 368 U.S. 899 (1961). Treaties are liberally construed to effect their purposes. *Eastern Airlines, Inc.* v. *Floyd*, 499 U.S. 530, 535 (1991); *Bacardi Corp. of America* v. *Domenech*, 311 U.S. 150, 163 (1940). A primary purpose of tax treaties is to prevent unfair or discriminatory taxation of the local activities of foreign taxpayers (their "permanent establishments"), which would put them at a competitive disadvantage in local markets.

A. The Court of Appeals' Interpretation of Article 24(2) Is Contrary to the Plain Language of the Treaty

Because the purpose of the Treaty's nondiscrimination clause is to protect the ability of a foreign taxpayer to compete in a

local market, the test for discrimination under that clause is whether the state imposes a greater tax burden on the foreign taxpayer based on its local activities than it would on a domestic business competing in the same market. Accordingly, Article 24(2) of the Treaty requires that the permanent establishment must be treated as a separate entity for the purpose of determining whether a tax is discriminatory.

It is undisputed that the activities carried on by Reuters New York branch constitute a "permanent establishment." *See* Treaty, Art. 5(2)(a), 31 U.S.T. at 5674. (19a.) It is also undisputed that Reuters New York branch does business in other states in the U.S. and must pay taxes in New York on income earned in all states in which it does business. Finally, it is undisputed that the total tax burden on the activities of foreign taxpayers can be no greater than that on the activities of domestic taxpayers, regardless of the method of taxation.

What *is* disputed is whether the Treaty language requires that Reuters New York branch be treated as a separate entity for the purpose of Article 24(2). The Court of Appeals found that because Reuters New York branch had no separate corporate identity, the tax fell on the Reuters corporate entity. The court then leapt to the conclusion that:

> The nondiscrimination clause requires a comparison * * * between the taxation of [Reuters'] United States branch located in New York and the taxation of a United States corporation having a branch in New York and conducting international business through branch offices in other countries.

(7a (citation omitted).)

Contrary to the finding of the Court of Appeals, however, the Treaty *unambiguously* makes the subject of the comparison the taxation of a "*permanent establishment*" — the local activities of the foreign taxpayer. The Treaty does not make the subject of comparison the taxation of the larger corporate entity of which the permanent establishment is a part. This is clear

from the text, which has as its subject "[t]he taxation *on a permanent establishment*" – not "the taxation *on the enterprise* of which the permanent establishment is a part" (emphasis added).

When Article 24(2)'s subordinate clause is dropped, it is clear that the phrase "carrying on the same activities" necessarily refers to the words "permanent establishment":

> The taxation on a *permanent establishment* . . . shall not be less favorably levied than the taxation levied on enterprises of that other State *carrying on the same activities*.

Treaty, Art. 24(2), 31 U.S.T. at 5687 (emphasis added).[13] The phrase "carrying on the same activities" requires that the permanent establishment be compared to a hypothetical New York company competing with Reuters New York branch in the same local market – *not* a hypothetical domestic corporation carrying on worldwide activities and competing with Reuters worldwide activities.

The Court of Appeals misread the Treaty in treating the phrase "the same activities" as referring to the phrase within the subordinate clause "an enterprise of a Contracting State" (the corporate entity as a whole). Thus, the court mistakenly concluded that the test for discrimination under the Treaty is to look to

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[13] Indeed, in explaining the provision, the commentaries of the Organization for Economic Cooperation and Development ("OECD") themselves drop the subordinate clause. They state: "The taxation of a permanent establishment shall not be less favorably levied in the State concerned than the taxation levied on enterprises of that State carrying on the same activities." OECD Committee Report on Fiscal Affairs, *Model Double Taxation Convention on Income and on Capital* 165, para. 23 (1977). The 1992 commentaries contain the identical statement. *OECD Model Tax Convention on Income and Capital*, Commentary, Article 24, p. 6, para. 21 (1992). All modern U.S. income tax treaties are based upon the OECD model, as are those of the other OECD members, including France, Germany and Japan. The OECD Model Convention is reprinted at 1 Tax Treaties (CCH) ¶ 201 (1977) and is published in English and French. The OECD commentaries are part of the legislative history of tax treaties and are an important guide to their meaning. *United States* v. *A.L. Burbank & Co., Ltd.*, 525 F.2d 9, 16 (2d Cir. 1975), *cert. denied*, 426 U.S. 934 (1976).

the national identity of the entire corporate entity and to ask whether New York purported to treat Reuters any differently because Reuters is a U.K. corporation rather than a U.S. corporation. (5a.)

According to the OECD, however, the purpose of the nondiscrimination provision[14] is

> to end . . . discrimination based *not upon nationality but on the actual situs* of an enterprise . . . to end all discrimination in the treatment of *permanent establishments* as compared with *resident enterprises* belonging to the same sector of activities, as regards taxes . . . and especially taxes on business profits.

OECD Committee Report on Fiscal Affairs, *Model Double Taxation Convention on Income and on Capital* 165 (1977) (emphasis added). In other words, the purpose of Article 24(2) is to permit foreign taxpayers to compete in local markets with no greater total tax expense than local businesses in the same market, regardless of whether a different *method* of taxation is imposed on the foreign taxpayer. Indeed, the purpose of a nondiscrimination clause in any tax treaty is to assure "that nationals (or residents) of each country will be put on a 'level playing field' with the nationals (or residents) of the other." American Law Institute, *Federal Income Tax Project, Tax Advisory Group Draft No. 20*, at 352 (Nov. 1, 1990). Absent such nondiscrimination provisions, foreign taxpayers could be subjected to tax burdens on their local activities that would make it impossible for them to compete with domestic concerns "carrying on the same activities."

Focusing on the jural identity of the corporate entity as a whole, as the Court of Appeals did, is contrary to the very purpose of Article 24(2). When Reuters New York branch is viewed as a separate entity, as required by Article 24(2), the

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[14] Article 24(2) of the Treaty is identical in wording and purpose to Article 24(4) of the Model Convention for the Avoidance of Double Taxation With Respect to Taxes on Income and on Capital promulgated by the OECD.

discriminatory nature of the tax is apparent. No New York company "carrying on the same activities" as Reuters New York branch would pay *any* income tax under any method of taxation – let alone nearly $100,000 in income tax – when it lost money. Thus, the greater tax burden on Reuters New York branch violates Article 24(2) of the Treaty.

The Appellate Division explicitly rationalized its misreading of Article 24(2) on the ground that Reuters "could have elected to do business in New York in subsidiary form rather than branch form and thus avoided the tax consequences which it finds objectionable." (15a.) While less explicit, that is the only possible meaning of the Court of Appeals' focus on Reuters New York branch's lack of a separate corporate and jural identity. (5a.) This analysis simply ignores the plain language of the Treaty. The Treaty protects the "permanent establishment" of a U.K. corporation, not merely a U.S. subsidiary of a U.K. corporation. There is *nothing* in the Treaty that requires that a permanent establishment incorporate in the United States in order to fall under the protection of Article 24(2). Indeed, it is precisely the right to do business as a "permanent establishment" in the form of an unincorporated branch that the Treaty protects. Treaty, Art. 5(2)(a), 31 U.S.T. at 5674; *see Kraft*, *supra*, 112 S. Ct. at 2369 (1992) ("we do not think that a state can force a taxpayer to conduct its foreign business through a domestic subsidiary in order to avoid discriminatory taxation of foreign commerce.").

B. The Court of Appeals' Interpretation of Article 24(2) Is Contrary to That of the Contracting States

This Court has held that "the meaning given [treaties] by the departments of government particularly charged with their negotiation and enforcement is given great weight." *Kolovrat* v. *Oregon*, 366 U.S. at 194 (1961) (footnote omitted); *see Factor* v. *Laubenheimer*, 290 U.S. 276, 294-95 (1933); *Nielson* v. *Johnson*, 279 U.S. 47, 52 (1929). Although no case other than the decisions below has been found in which Article 24(2) has been interpreted or applied by a United States court, both the U.S. Treasury Department ("Treasury") and the U.K. Board of Inland Revenue ("Inland Revenue") have interpreted Article

24(2) to require that a permanent establishment be treated as a separate entity in the "test" for tax discrimination. The Court of Appeals improperly ignored these interpretations.

In Notice 89-80, 1989-2 C.B. 394, Treasury examined and interpreted Article 24(2) in determining whether the U.S. withholding tax imposed by 26 U.S.C. § 884(f)(1)(B) of the Internal Revenue Code on excess interest paid by domestic branches of foreign corporations (the branch "excess interest" tax) is discriminatory. 1989-2 C.B. at 397. Critical to Treasury's analysis was its finding that the test for discrimination under Article 24(2) required that the permanent establishment be treated *as if it were a domestic subsidiary* – *i.e.*, as a separate entity instead of a branch – of the foreign corporation of which it is a part.

In 1986, Congress changed the method by which the United States calculates the withholding taxes payable on interest paid, or deemed paid, by U.S. permanent establishments of foreign corporations. Under the new system, the permanent establishment is allowed a tax deduction for an allocated portion of the interest paid by the company of which it is a part. To the extent that this deduction is larger than the interest actually paid by the U.S. permanent establishment ("excess interest"), the excess is treated as having been paid to the home office and thus may be subjected to a U.S. withholding tax. Treasury concluded that the measure does not violate the nondiscrimination clause because it treats the "U.S. branch as if it were a wholly-owned domestic subsidiary of a foreign corporation," *id.* at 397, thus interpreting Article 24(2) precisely as Reuters contends in this case.

Had Treasury taken the position adopted by the Court of Appeals, then the Treaty would call for a comparison between the taxation of the U.S. permanent establishment and the taxation of a domestic corporation with worldwide activities identical to those of the foreign corporation of which the permanent establishment was a part. In that event, the U.S. tax on excess interest clearly *would* violate the nondiscrimination clause because the hypothetical domestic corporation would not be subject to a U.S. withholding tax on payments from its U.S. branch

to other branches of the corporation. Thus, the Court of Appeals decision effectively declared the Treasury Department's interpretation of its own Treaty to be invalid, at least in New York.

Inland Revenue – the U.K.'s counterpart to the I.R.S. – has stated that the proper comparison for the "test" of discrimination under Article 24(2) is to compare the permanent establishment to a hypothetical domestic corporation engaged in the same activities as the permanent establishment. It has declared that its interpretation of the nondiscrimination clause is "correctly summarized" as follows:

> [T]he comparison necessary to test the application of the non-discrimination Article is made by substituting *for the United Kingdom branch* of the non-resident [United States] corporation *a United Kingdom resident company* related to the first company exactly as the branch is related – through the common ownership and control of the United States corporation.

3 *British Tax Review* 151 (1977) (emphasis added), *cited in* Inland Revenue Letter, *reprinted in* 3 *British Tax Review* 198 (1978).

Because the Court of Appeals holding is flatly contrary to the interpretation given to Article 24(2) by both parties to the Treaty, New York may now frustrate the provisions of the Treaty as agreed, interpreted, and applied by the federal government and the government of the United Kingdom. This Court, however, has explicitly warned "that rules of international law should not be left to divergent and perhaps parochial state interpretations." *Banco Nacional de Cuba* v. *Sabbatino*, 376 U.S. 398, 425 (1963); *see First National City Bank* v. *Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 622 n.11 (1983).

C. The Court of Appeals' Decision Is in Direct Conflict with Decisions from Other OECD Countries Interpreting Nondiscrimination Provisions Identical to Article 24(2)

The Court of Appeals interpretation of Article 24(2) is in conflict with decisions in France and Germany interpreting tax

treaty provisions identical, or virtually identical, to Article 24(2).[15] Inconsistent judicial construction of treaty provisions puts the United States in conflict with other treaty signatories. "Inconsistency of interpretation is particularly undesirable where, as here, the decision affects commercial behavior." *Distribuidora Dimsa* v. *Aerea del Cobre*, 768 F. Supp. 74, 78 (S.D.N.Y. 1991), *aff'd*, 976 F.2d 90 (2d Cir. 1992). Again, the Court of Appeals improperly ignored the French and German decisions.

The Conseil d'Etat – the highest court in France for tax matters – has found, in a case involving the French branch of an Italian insurance company, that the required comparison under a tax treaty provision identical to Article 24(2) is between a foreign company's local branch and a local company engaged in the same activity *as the foreign branch*. In other words, for purposes of the nondiscrimination clause, the local branch must be treated as if it were a separate local company for tax purposes even though it has no separate corporate identity. *See Judgment of November 18, 1985*, Conseil d'Etat (Fr.) (62a-64a). In this case, the French branch received a dividend from a French subsidiary of the Italian company. The French branch claimed a refund of the major part of the tax paid on the dividend because a French company would have been entitled to the same refund. The French Tax Administration contended that the Treaty required that the entire Italian company – not just the French branch – serve as the basis for the comparison with a French corporation in the test for tax discrimination – the same analysis the Court of Appeals adopted in this case. The Conseil d'Etat *rejected* this view of the nondiscrimination provision:

> [T]he branch in France of an Italian company, if it constitutes, as in this case, a permanent establishment within the meaning of the convention, must, *even if*

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[15] Reuters is unaware of any other court decisions from other countries or of any United States court decisions interpreting such nondiscrimination provisions. Translations of the French and German decisions are annexed hereto as Appendices G and H for the Court's convenience. The decision of the French court and the annexed English translation were part of the record below (R. at 321-24, 338-40); the German decision and the annexed English translation were appended to Reuters briefs in the Appellate Division and the Court of Appeals.

> *it does not constitute a judicial entity by itself* under French internal law, benefit from a tax regime that is not less favorable than that accorded to a French company . . . .

Id. (in translation) (64a) (emphasis added).

The role of the taxpayer and the government were reversed in a German case, *Judgment of March 30, 1973*, Finanzgerichte in Dusseldorf (tax trial court), 10 Entscheidungen der Finanzgerichte [EFG] 509 (F.R.G.) (57a-61a). At issue was the German capital tax imposed upon capital contributions made by foreign corporations to their German branches. Relying on a tax treaty nondiscrimination provision based upon the OECD Model, a Japanese taxpayer made the same "whole-company" comparison adopted by the Court of Appeals and argued that it suffered prohibited discrimination because a German company would not have incurred the tax by transferring funds to its local branch. (57a.) The German court rejected this analysis and held that the applicable comparison for purposes of the treaty was between the Japanese company's German branch and a hypothetical German company engaged in the same activities as that branch, holding that the local branch must be treated as a separate entity for the purpose of measuring discrimination under the tax treaty. (58a.) Because the capital tax would be payable on contributions to a separately incorporated German subsidiary, the tax on the contribution to the German branch was held not to be discriminatory. (60a.)[16] Again, the treaty required that the foreign company's branch be treated as a separate entity, and then compared to a local corporation conducting the same business as the *branch*.[17]

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[16] To hold otherwise would have given the Japanese corporation a competitive advantage over the domestic corporation because a German company would have to incur the cost of the capital contribution, while the German branch of the Japanese corporation would be able to compete in the German market without that cost.

[17] The decision below is also contrary to the view of the leading academic commentator on international tax treaties, Professor Klaus Vogel of the University

(Footnote continued)

The importance of international consistency of interpretation of tax treaties strongly militates in favor of this Court reviewing the contrary decision of the court below and settling this issue. Indeed, the need for international consistency of interpretation is at its greatest with respect to the interpretation of provisions that bar discrimination. For it is in applying such guarantees that courts are likely to face the greatest pressures to bow to the expediency of increasing domestic revenues — or promoting domestic businesses — at the expense of politically impotent foreigners.

D. The Legislative History of Article 9(4) Has No Relevance to Article 24(2)'s Prohibition of Discrimination in State Taxation

The Court of Appeals found that the legislative history of Article 9(4) of the Treaty demonstrated a Congressional intent not to restrict state taxation of corporate income earned outside the United States. (7a.) Article 9(4) was proposed to prevent the application of worldwide unitary taxation, of the type adopted by California, to U.K.-based corporate groups. Under pressure from states that practice this type of taxation, this restriction was dropped from the final Treaty. However, Article 9(4) is not relevant here because the *method* of taxation does not figure into the analysis of discrimination under Article 24(2). That

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of Munich. Professor Vogel's treatise, Klaus Vogel *et al.*, *Klaus Vogel on Double Taxation Conventions* (1991), confirms that the Treaty requires that the permanent establishment be treated as a separate entity and that the applicable comparison under the nondiscrimination clause is between a branch of a foreign corporation (the "permanent establishment") and a domestic corporation (a "legally independent enterprise") that is "engaged in the same activities."

> Determination of whether or not there is discrimination requires a *hypothetical comparison with an enterprise engaged in the same activities and located in the State in which the permanent establishment is situated*. Such a comparison must be based on the *fictitious* assumption that the permanent establishment is *assimilated for tax purposes* — when in reality it is not — *to a legally independent enterprise* of the State in which the permanent establishment is situated . . . .

Id. at 1132 (emphasis in original) (citations omitted). *Accord* William C. Gifford, *Permanent Establishments Under the Nondiscrimination Clause in Income Tax Treaties*, 11 Cornell Int'l L.J. 51 (1978).

provision simply requires that — whatever method of taxation is used — the *total tax burden* be no greater on the activities of the permanent establishment than on those of its domestic competitor. As the Senate Report on the Treaty makes clear:

> Under the protocol, political subdivisions and local authorities of either country are free to use formula methods to apportion income, deductions and other items among related enterprises in determining income subject to their taxes, *so long as such methods do not violate the proposed treaty's non-discrimination provisions* (Article 24).

Third Protocol to the 1975 Income Tax Convention, as amended, U.S.-U.K., S. Exec. Doc. Q, 96th Cong., 1st Sess. 5 (1979) (emphasis added).[18]

II. THE EXTRAORDINARY TAX COMPLIANCE BURDEN DISCRIMINATES AGAINST REUTERS IN VIOLATION OF THE TREATY AND THE FOREIGN COMMERCE CLAUSE

When applied to Reuters on a worldwide basis, the compliance burden that New York's tax scheme imposes upon Reuters violates Article 24(2) and the Foreign Commerce Clause. Reuters, unlike a New York taxpayer, must either pay approximately $1,000,000 annually in additional administrative costs to keep the required books and records in conformance with New York tax requirements, or chance arbitrary — and excessive — assessments made from approximations. *See* Kirsten Schlenger, Note, *State Worldwide Unitary Taxation: The Foreign Parent Case*, 23 Colum. J. Transnat'l L. 445, 473 (1985).[19]

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[18] The Court of Appeals' reliance on Article 7(2) of the Treaty, which expressly denies the federal government (but not the states) the power to use the formulary apportionment method (8a) is similarly misplaced. Article 24(2) does not require that the state treat Reuters branch as a separate entity for *all* purposes or tax it separately; rather, Article 24(2) requires only that when *testing* for discrimination, the appropriate comparison is to view the permanent establishment as a separate entity and measure its tax burden against that of a hypothetical local competitor.

[19] The requirement that Reuters keep its records worldwide in accordance with New York tax standards violates the international norm in which multinational companies typically keep only the records of their local operations in accordance with local tax and accounting practices, and conform the records of *all* their operations only to the requirements of their home country.

The Court of Appeals ignored the evidence of Reuters compliance costs on the ground that Reuters "'was able to promptly supply information to the Tribunal to reduce the deficiencies initially indicated.'" (9a, 16a.) The *uncontroverted* evidence, however, shows that the Tax Department reduced its deficiency assessment because it made two glaring computational errors; and, having itself employed noncomplying book figures rather than tax figures to make the calculations, it permitted Reuters to do so to correct them. *See* pp. 5-6, *supra*. It is the approximately $1 million annual cost of *compliance* with New York's tax law – not the cost of providing *noncomplying* data, which New York may accept or reject – that amounts to an unfair and discriminatory burden.

The decision below allows a taxing jurisdiction to do indirectly what the Treaty prohibits it from doing directly – use tax laws to impose a disproportionate cost of doing business in the local market on a foreign competitor. Indeed, were each country in which Reuters does business to require Reuters to maintain worldwide records in accordance with its own tax laws, the administrative burden could destroy Reuters or force it out of those markets. Clearly, Article 24(2) prevents this type of discriminatory compliance costs.

As the Court of Appeals recognized, the cost of compliance with a state tax scheme may amount to an unfair and discriminatory burden that violates the Foreign Commerce Clause. (9a.) Indeed, this Court has pending before it a case that raises this precise cost of compliance issue with respect to worldwide unitary taxation. *See Barclays*, *supra*.[20] A state's power to tax may not be used with the aim *or effect* of establishing economic barriers against competition. *Tyler Pipe Industries, Inc.* v. *Dep't of Revenue*, 483 U.S. 232, 243 (1987); *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 329 (1977).

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[20] In *Barclays*, as here, the state court mistakenly concluded that the possibility that the state might accept noncomplying information was sufficient to avoid an unconstitutional discriminatory compliance burden imposed on the foreign taxpayer. *Barclays*, 10 Cal. App. 4th 1742, 1762 (1992), *pet. for cert. granted*, 114 S.Ct. 379 (1993).

Moreover, "the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate commerce." *Kraft*, 112 S. Ct. at 2370; *see Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 445-51 (1979).

The test to determine whether a tax or regulatory statute discriminates against interstate or foreign commerce is one of "economic realities." *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977). Cost, along with other factors, is an important determinant of whether a burden on commerce rises to constitutional proportions. *Raymond Motor Transp. Inc.* v. *Rice*, 434 U.S. 429, 445 (1978); *Bibb* v. *Navajo Freight Lines Inc.*, 359 U.S. 520, 526 (1959). The economic reality of the $1,000,000 annual cost of compliance clearly amounts to such an unconstitutional discriminatory burden. Indeed, the prohibitive burden of compliance is an even more potent weapon against foreign commerce than the burden imposed by the tax itself, a total of less than $100,000 for three years.

The state courts are not free to ignore unrefuted record evidence or to rely on a taxpayer's ability to provide noncomplying information in order to save a blatantly discriminatory tax reporting scheme from a Foreign Commerce Clause or Treaty challenge. Yet that is precisely what the courts below did. (9a, 15a.) When the *undisputed* record evidence is properly considered, it is clear that this is, indeed, *the* occasion "when the cost of compliance warrants a finding that the State's tax laws discriminate against foreign commerce" (16a), in violation of the Constitution and the Treaty.

III. THE NEW YORK FRANCHISE TAX REGULATIONS ARE FACIALLY UNCONSTITUTIONAL BECAUSE THEY DISCRIMINATE AGAINST FOREIGN COMMERCE

Eight days after the Appellate Division rendered its decision in this case, this Court decided *Kraft*, *supra*, 112 S. Ct. 2365. The *Kraft* decision highlights an inequity in New York's taxation of foreign source income that renders New York's tax scheme facially unconstitutional under the Foreign Commerce Clause.

As noted, *supra*, n. 11, the Court of Appeals did not directly address Reuters constitutional argument under *Kraft*.[21]

Kraft involved the constitutionality of an Iowa statute that taxed dividends received from foreign subsidiaries, but not dividends received from domestic subsidiaries. This scheme resulted not from intentional discrimination, but from Iowa's adoption of the federal definition of "net income" without making the adjustments necessary to afford equal treatment to dividends from domestic and foreign subsidiaries. 112 S. Ct. at 2370. This Court held that Iowa's taxation scheme was a facial violation of the Foreign Commerce Clause:

> [W]e think that a State's preference for domestic commerce over foreign commerce is inconsistent with the Commerce Clause even if the State's own economy is not a direct beneficiary of the discrimination. As the absence of local benefit does not eliminate the international implications of the discrimination, it cannot exempt such discrimination from Commerce Clause prohibitions.

Id.

As did the Iowa scheme in *Kraft*, the New York scheme relies on an interplay of federal and New York provisions to define the taxable income of foreign corporations doing business in the state. Section 208(9) of the Tax Law provides:

> The term "entire net income" means total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department. . . .

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[21] Instead, the court held that Reuters Foreign Commerce Clause challenge was foreclosed by Bass, *supra*. The only issue *Bass* resolved, however, was that it is not a *per se* violation of the Foreign Commerce Clause to tax a foreign corporation doing business in New York on the basis of income earned abroad. *Bass* did *not* address the constitutionality of New York's tax regulation that discriminates against foreign source income, the issue raised before the Court of Appeals.

To compute "entire net income," federal income must be adjusted by adding:

> in the case of a taxpayer organized outside the United States, all income from sources outside the United States less all allowable deductions attributable thereto, which were not taken into account in computing Federal taxable income.

20 NYCRR 3-2.3(a)(9). The New York scheme thus requires a foreign taxpayer to include "*all* income from sources outside the United States" in its "entire net income," but limits the domestic income to be included to income that the taxpayer is required to report to the IRS. This scheme is facially discriminatory in the manner condemned by *Kraft* because a foreign taxpayer need *not* report "all" U.S. income to the federal government.

Reuters was affected by New York's facial discrimination against foreign source income. New York's regulations require that Reuters add to its New York income *all* the income earned from its activities in approximately 80 foreign countries. Yet Reuters is not required to include in its New York income U.S. source capital gains on U.S. investment securities earned by its London branch because that income is properly excluded from Reuters federal income.[22] New York's facial discrimination against income earned abroad must, therefore, fall under *Kraft*.

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[22] Gains on the sales of investment securities, and the holding of U.S. securities, were reported on Reuters original 1977 franchise tax return, but eliminated on the corrected 1977 return, which reported only the activities of Reuters U.S. Branch – not those of its London branch. (R. at 230-33, 247-50.)

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Dated: January 10, 1994

Respectfully submitted,

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APPENDIX

APPENDIX A

REMITTITUR

Court of Appeals
State of New York

The Hon. Judith S. Kaye, Chief Judge, Presiding

3 No. 186

In the Matter of Reuters Limited,

Appellant,

v.

Tax Appeals Tribunal et al.,

Respondents.

The appellant in the above entitled appeal appeared by Weil Gotshal & Manges, Esqs. and Stuart H. Simon, Esq.; the respondents appeared by Hon. Robert Abrams, Attorney General of the State of New York.

The Court, after due deliberation, orders and adjudges that the judgment is affirmed, with costs. Opinion by Judge Bellacosa. Chief Judge Kaye and Judges Simons, Titone, Hancock and Smith concur. Judge Levine took no part.

The Court further orders that this record of the proceedings in this Court be remitted to the Appellate Division, Third Department, there to be proceeded upon according to law.

I certify that the preceding contains a correct record of the proceedings in this appeal in the Court of Appeals and that the papers required to be filed are attached.

/s/ Donald M. Sheraw

Donald M. Sheraw, Clerk of the Court

Court of Appeals, Clerk's Office, Albany, October 12, 1993.

APPENDIX B

State of New York
Court of Appeals

3 No. 186
In the Matter of Reuters Limited,

Appellant,

v.

Tax Appeals Tribunal et al.,

Respondents.

OPINION

This opinion is uncorrected and subject to revision before publication in the New York Reports.

Steven Alan Reiss, for appellant.
Daniel Smirlock, for respondents.

BELLACOSA, J.:

In this article 78 proceeding, petitioner-appellant Reuters Limited challenges a corporate franchise tax deficiency assessment. At issue is whether New York State's calculation of petitioner's franchise tax on the basis of the worldwide net income apportionment method violates the nondiscrimination clause of the United States-United Kingdom Tax Treaty (Convention Between United States and United Kingdom for Avoidance of Double Taxation, Dec. 31, 1975, 31 UST 5668). We agree with the conclusion of the Appellate Division that application of New York's apportionment formula to the worldwide net income of a single multijurisdictional business enterprise, operating internationally, does not violate the Treaty's nondiscrimination clause. The Appellate Division judgment, confirming the determination of the Tax Appeals Tribunal and the Commissioner of Taxation and Finance, should be affirmed.

Reuters Limited, a corporation organized in the United Kingdom, does business in approximately 80 countries. During taxable years 1977 through 1979, it maintained a branch office in New York City, which served as its principal United States office. Although Reuters earned profits abroad during the tax years in question, its New York branch incurred losses. Reuters computed its corporate franchise taxes for the tax years 1977 through 1979 on the basis of United States income only, and paid no franchise tax for those years because it also claimed losses on its United States operations. In 1983, the Department of Taxation and Finance performed an audit using the worldwide net income apportionment method and issued notices of deficiency totalling $1,280,000 for the tax years 1977 through 1979. The parties eventually compromised the deficiency amount down to $96,168.

Irrespective of the modification as to the amount owed, Reuters filed an administrative petition challenging the deficiency itself. An Administrative Law Judge sustained the notices of deficiency. After the Tax Appeals Tribunal affirmed the Administrative Law Judge's determination, Reuters commenced

this article 78 proceeding seeking to annul the determination of deficiency. The Appellate Division unanimously confirmed the determination and dismissed the petition in a well-reasoned opinion by Justice Paul Yesawich, Jr. After this Court dismissed an appeal taken as of right on the ground that no substantial constitutional question was directly involved (80 NY2d 971), we granted Reuters leave to appeal.

I.

When computing the corporate franchise tax of a multi-jurisdictional international entity doing business in New York, an apportionment formula is used to determine the aliquot share of the corporation's worldwide net income attributable to New York. The first step is to calculate a "business allocation percentage", which is ascertained by comparing the value which the corporation's real and tangible personal property within New York bears to the worldwide value of the same factors (Tax Law §210[3][a][1]). The corporation's worldwide business income is then multiplied by the business allocation percentage to arrive at the entire net income base, i.e., the portion of the taxpayer's entire net income allocable to and taxable by New York (*id.*, §§210[3][a], 210[1][a]). New York's corporate franchise tax is computed at the rate of nine percent of the taxpayer's entire net income base (*id.*, §210[1][a]).

Article 24(2) of the U.S.-U.K. Tax Treaty, the antidiscrimination tax clause at the heart of this dispute, provides:

> "The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State *shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities*" (31 UST 5668, 5687 [emphasis added]).

Article 24(2) is made applicable to the political subdivisions of the Contracting States through article 2(4).

Initially, we are in agreement with the Appellate Division's observation that the language of the antidiscrimination clause is ambiguous. Specifically, it is unclear whether the truncated phrase "carrying on the same activities" requires that the domestic subject of comparison for assessing discrimination be the permanent establishment (branch) or the corporate enterprise of which the permanent establishment is a part. Reuters would have the courts construe article 24(2) as requiring that claims of discriminatory treatment be analyzed by comparing the taxation levied on its New York branch (permanent establishment) with the taxation levied on a hypothetical New York corporation (enterprise of that other State) carrying on business only in New York and conducting activities similar to those carried on by Reuters at its New York branch. Reuters further contends that the Treaty test for discrimination requires that its New York branch be treated for tax purposes as an enterprise discrete from the corporate parent in the United Kingdom. Under Reuters' construction of the critical clause, a hypothetical New York corporation that earned no income outside this State would not be subject to the worldwide net income apportionment method. Thus, Reuters argues that its New York branch has been treated "less favorably" than required by article 24(2) of the Treaty.

The syllogism fails. Reuters-New York, as a branch of the United Kingdom enterprise, is not juridically equivalent to a free-standing entity as proposed in its hypothetical analogy. Reuters-New York cannot be lifted out of and placed in the isolation of its own legal universe, for the tax and juridical realities under the antidiscrimination clause are otherwise. As the Appellate Division aptly noted, a branch office "has no corporate or jural identity separate from the corporation of which it is a part" (*Matter of Reuters Limited v Tax Appeals Tribunal*, 180 AD2d 270, 272). Moreover, the purpose of the nondiscrimination clause is to protect foreign taxpayers against local economic discrimination derived from disparate tax treatment. The ultimate taxpayer here is the corporate entity, Reuters-United Kingdom, not its branch affiliate. Thus, to measure the potential discriminatory effect of New York's franchise tax, by

reference to Reuters' New York branch as an enterprise discrete from its juridical parent, is not supportable under the language or purpose of the nondiscrimination clause. We conclude that Reuters-United Kingdom (enterprise) and its New York branch office (permanent establishment) are a single, inseparable business enterprise for franchise tax purposes.

Reuters' contention that Treaty article 24(2) requires that its New York business activities be considered in isolation also amounts to a flank attack on the "unitary business" principle. The United States Supreme Court, however, has upheld and described that principle as "the linchpin of apportionability in the field of State income taxation" (*Mobil Oil Corp. v Commissioner of Taxes*, 445 US 425, 438). Due to the increasingly intricate integration of national and international multijurisdictional corporations, the task of territorially tracking business income to discrete and remote sources has become an elusive endeavor. States have justifiably adopted formulary income apportionment methods to ascertain the income actually earned in a taxing jurisdiction by an integrated business enterprise operating multijurisdictionally. As a counterbalance to the insatiable and inventive quest for revenues, however, the measures undertaken must, of course, satisfy constitutional and organic law safeguards, and courts must factor in such concerns when resolving challenges to and disputes arising out of the various methodologies (*see*, *Container Corp. v Franchise Tax Bd.*, 463 U.S. 159, 164-166).

We are unable to accept Reuters' contention that a New York corporation carrying on business solely in New York is the equivalent domestic subject of comparison (enterprises of another State) for measuring discrimination under the Treaty. An "enterprise" is defined in article 3(1)(d) of the Treaty as "an industrial or commercial undertaking carried on by a resident of a Contracting State" (31 UST 5671). A "resident of a Contracting State" is in turn defined as a United States or United Kingdom corporation (arts 3[1][i], 4[1], *id.*, at 5671-5672). Making use of the appropriate Treaty definitions, we conclude that the domestic subject of comparison under the Treaty is an

industrial or commercial undertaking carried on by a United States corporation. When the commercial undertaking is the branch office of a United States corporation, we reiterate that the branch and the corporation are a single business enterprise for franchise tax purposes. That analysis provides the correct comparability for the controversy at hand.

In sum, our analysis leads us to agree with the Appellate Division that "the nondiscrimination clause requires a comparison * * * between the taxation of [Reuters'] United States branch located in New York and the taxation of a United States corporation having a branch in New York and conducting international business through branch offices in other countries" (*Reuters*, 180 AD2d at 273-274, *supra*). Employing this comparison, we note that New York's calculation of Reuters' franchise tax on the basis of worldwide net income apportionment results in nondiscriminatory tax treatment. Accordingly, we hold that article 24(2)'s requirement of no less favorable treatment has been satisfied.

The Treaty's legislative history also buttresses this conclusion. Article 9(4) of the Treaty, which the Senate ultimately refused to ratify, originally prohibited States from employing the California-type worldwide combined reporting methodology. That practice involves application of an apportionment formula to the combined worldwide income of related corporate affiliates and subsidiaries. The legislative history surrounding article 9(4) discloses that State use of worldwide formulary apportionment methods as applied to a single business enterprise would remain unaffected by the proposed Treaty restriction. The Senate Foreign Relations Committee's Report on the Treaty states:

> "[I]f a U.S. branch of a British Corporation does business in a state, that state cannot apply [California's] unitary method to combine the income * * * of any related foreign enterprises * * * with those of that British corporation in determining the income of its U.S. branch which is taxable by that state. *However, that state may take into account the income*

> *and assets of any other branches of that corporation, wherever located, because a corporation is considered to be a single enterprise regardless of how many separate branches or businesses it has*" (Senate Executive Report No. 95-18, 1980-1981 C.B. 411, 420 [emphasis added]).

The Treasury Department's technical explanation of the treaty also reflects the view that article 9(4)'s prohibition on State taxation was not to extend to the single enterprise modus operandi:

> "Because a corporation is considered a single enterprise regardless of how many branches it has, a state may take into account the income and assets of all branches of that corporation, wherever located" (Treasury Department Technical Explanation, 1980-1981 C.B. 455, 462).

While we do not presume to review or pass on the validity of any other tax schemes, the argument that the Treaty's drafters intended article 24(2) as an indirect curtailment on the open and widespread use of worldwide income apportionment methods strains credulity and proper interpretation. Forty-one States, including New York, currently apply an apportionment formula to the worldwide net income of a single business enterprise operating multijurisdictionally (*see*, Note, *Desperate for Revenue: The States' Unconstitutional Use of the Unitary Method to Apportion the Taxable Income of Foreign Parent Corporations*, 19 Hastings Const. L.Q. 1077, 1080-1081). Four other States, including California, apply an apportionment formula to the combined worldwide income of related corporations operating multijurisdictionally (*id.*). In fact, the Treaty expressly denies the Federal government the power to use formulary apportionment in article 7(2) and is tellingly silent in that regard with respect to the States' long-standing power and their varied implementation.

In a separate argument, Reuters claims that New York's use of worldwide net income apportionment violates the Foreign

Commerce Clause (US Const, art I, §8). In *Bass, Ratcliff & Gretton, Ltd. v State Tax Commission* (266 US 271), the Supreme Court of the United States rejected a Foreign Commerce Clause challenge to the validity of New York's apportionment methodology on similar facts. Bass, a British corporation with worldwide net income exceeding $2,000,000 for the tax year in question, maintained a branch office in New York that had no net income for the same period. The New York Tax Commission allocated a share of Bass's worldwide income to New York and assessed a franchise tax on the allocated amount. The United States Supreme Court held that New York's use of worldwide income apportionment did not burden foreign commerce (*id.*, at 282-283). The Supreme Court noted that Bass was carrying on a unitary business "in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places" (*id.*, at 282). The Court ruled that New York was justified in attributing to itself "a just proportion of the profits earned by the Company from such unitary business" (*id.*). *Bass* has been reaffirmed by modern Supreme Court tax jurisprudence (*see, Mobil Oil Corp. v Commissioner of Taxes*, 445 US 425, 438-439).

In this respect, we also observe that Reuters argues that New York's statutory income apportionment technique imposes unconstitutionally discriminatory compliance costs on foreign commerce. The Appellate Division basically rejected Reuters' argument on this issue for failure of sufficient factual showing: "[T]he averment *** that the cost of compliance would be nearly $1 million per year is sorely undermined by the fact that [Reuters] was able to promptly supply information to the Tribunal to reduce the deficiencies initially indicated" (*Reuters*, 180 AD2d at 275, *supra*). Thus, we cannot and need not speculate on whether the cost of complying with New York's tax methodology unconstitutionally burdens foreign commerce (*but see, Bibb v Navajo Freight Lines*, 359 US 520, 526).

Because the constitutional challenge in this case runs into such relevant *stare decisis* barriers and falters also on an essentially unsatisfied fact-qualifying threshold, this Court need not discuss

further the merits of the constitutional objection. We note, also, that we previously dismissed the appeal taken as of right by Reuters on constitutional grounds, which we found jurisdictionally wanting.

Accordingly, the judgment of the Appellate Division should be affirmed, with costs.

* *

Judgment affirmed, with costs. Opinion by Judge Bellacosa. Chief Judge Kaye and Judges Simons, Titone, Hancock and Smith concur. Judge Levine took no part.

Decided October 12, 1993

APPENDIX C

COURT OF APPEALS ORDER GRANTING LEAVE TO APPEAL DATED FEBRUARY 11, 1993

State of New York, Court of Appeals

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the eleventh *day of* February *A.D. 1993*

Present, HON. RICHARD D. SIMONS,
Acting Chief Judge, presiding.

3-10 Mo. No. 1285

In the Matter of Reuters Limited,

Appellant,

v.

Tax Appeals Tribunal et al.,

Respondents.

A motion for leave to appeal to the Court of Appeals in the above cause having been heretofore made upon the part of the appellant herein and papers having been duly submitted thereon and due deliberation thereupon had it is

ORDERED, that the said motion be and the same hereby is granted.

/s/ Donald M. Sheraw

Donald M. Sheraw
Clerk of the Court

APPENDIX D

APPELLATE DIVISION, THIRD DEPARTMENT
OPINION AND JUDGMENT DATED JUNE 11, 1992
[Pages 351 - 355]

Supreme Court—Appellate Division
Third Judicial Department

Decided and Entered: June 11, 1992

In the Matter of REUTERS LIMITED,

Petitioner,

v. OPINION AND JUDGMENT

TAX APPEALS TRIBUNAL et al.,

Respondents.

Calendar Date: April 27, 1992

Before: Mikoll, J.P., Yesawich Jr., Levine, Mercure and Harvey, JJ.

Weil, Gotschal & Manges (Steven A. Reiss of counsel), New York City, for petitioner.

Robert Abrams, Attorney-General (Daniel Smirlock of counsel), Albany, for Commissioner of Taxation and Finance of the State of New York, respondent.

Yesawich Jr., J.

Proceeding pursuant to CPLR article 78 (initiated in this court pursuant to Tax Law § 2016) to review a determination of respondent Tax Appeals Tribunal which sustained a franchise tax assessment imposed under Tax Law articles 9-A and 27.

Petitioner is a corporation organized in the United Kingdom with a branch office in New York City serving as its main office in the United States. The branch office has no corporate or jural identity separate from the corporation of which it is a part. Petitioner appeals from a determination of respondent Tax Appeals Tribunal affirming the determination of an Administrative Law Judge upholding New York's corporate franchise tax, which is calculated on the basis of the portion of petitioner's corporate worldwide net income that can be allocated to the activity conducted in New York (hereinafter the worldwide net income apportionment method) (*see*, Tax Law § 208 [9] [c]; § 209 [1]; § 210 [1] [a]; [3]).

Petitioner, which was engaged in the business of supplying news, economic and financial information by electronic means to newspapers, banks and other interested entities in approximately 80 countries worldwide, calculated its 1977, 1978 and 1979 New York corporation franchise tax solely on the basis of income from United States sources; significantly, petitioner suffered losses in New York but earned profits abroad during these tax years. In 1983 the Department of Taxation and Finance issued notices of deficiency for such tax years in the total amount of $1,280,000; the amount owed was calculated using the worldwide net income apportionment method. Asserting that this method violated the nondiscrimination clause of a United States-United Kingdom tax treaty (Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, art 24, § 2, 31 UST 5670, 5687) (hereinafter the US-UK Tax Treaty) and the Foreign Commerce Clause of the Federal Constitution (US Const, art I, § 8), petitioner sought a redetermination of the deficiency from the Tax Appeals Bureau. As a result of a conference held by the parties and additional information supplied by petitioner, the total deficiency amount was reduced to $96,168; the request for redetermination was thereafter twice modified and perfected. The Department of Taxation and Finance answered, a hearing was held,

and the Administrative Law Judge denied the petition and sustained the notices of deficiency as modified at the conference. Petitioner filed exceptions with the Tribunal. When the exceptions were denied petitioner commenced the instant proceeding seeking, *inter alia*, an annulment of the Tribunal's determination. Respondent Commissioner of Taxation and Finance answered and submitted the documents constituting the record before the Tribunal.

Tax Law § 209 (1) requires that "[f]or the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in this state in a corporate or organized capacity, or of maintaining an office in this state*** *every domestic or foreign corporation* ***shall annually pay a franchise tax, upon the basis of its entire net income" (emphasis supplied), which includes income earned "within and without the United States" (Tax Law § 208 [9] [c]; *see*, 20 NYCRR 1-3.2 [2]; 3-2.2 [a]). Because it treats domestic and foreign corporations uniformly, such tax does not violate the US-UK Tax Treaty's nondiscrimination clause (31 UST 5670, 5687). That clause provides that "[t]he taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State *carrying on the same activities*" (*id.* [emphasis supplied]). Although petitioner urges that this clause requires a comparison between the taxation on its United States branch located in New York and a New York corporation engaged in conducting business solely in New York, inserting the appropriate definitions of the US-UK Tax Treaty (*see*, *id.*, at 5671-5674) we believe the nondiscrimination clause requires a comparison, as propounded by the Attorney-General, between the taxation of petitioner's United States branch located in New York and the taxation of a United States corporation having a branch in New York and conducting international business through branch offices in other countries.

We consider the clause ambiguous with regard to whether the phrase "carrying on the same activities" refers to the

activities of the permanent establishment, i.e., the branch, or to the corporation of which the branch is a part, i.e., petitioner (*see*, Gifford, *Permanent Establishments Under the Non-discrimination Clause in Income Tax Treaties*, 11 Cornell Intl L.J. 51 [1978]). What must not be lost sight of is the fact that the tax here is a franchise tax imposed on petitioner, the corporate entity, and that a United States corporation "carrying on the same activities" as the petitioning corporation with a New York branch and worldwide branch activities would be subject to the very same tax as petitioner. And petitioner, like a United States corporation, could have elected to do business in New York in subsidiary form rather than branch form and thus avoided the tax consequences which it finds objectionable (*see*, 20 NYCRR 6-2.5 [b]).

The US-UK Tax Treaty's legislative history confirms that the limitation the Treaty imposes on state taxation does not extend so far as to prohibit the tax methodology employed here. That history clearly manifests an intent, at least where a single corporation is involved, to allow the states the freedom to tax branches of a United Kingdom corporation on the basis of the corporation's worldwide income as allocated to each state. As the Senate Executive Report illustrates, if "for example*** a U.S. branch of a British corporation does business in a state, that state *** may take into account the income and assets of any other branches of that corporation wherever located, because a corporation is considered to be a single enterprise regardless of how many separate branches or businesses it has" (Senate Executive Report No. 95-18, 1980-81 C.B. 411, 420; *see*, Senate Executive Report No. 96-5, 1980-81 C.B. 440, 441; Treasury Dept. Technical Explanation of the Convention, 1980-81 C.B. 455, 462). The foreign decisions brought to our attention by petitioner do not compel a conclusion different from that which we have reached.

As for the argument that New York's worldwide net income apportionment method violates the Foreign Commerce Clause, it too is of no avail (*see generally*, Note, *State Worldwide Unitary Taxation: The Foreign Parent Case*, 23 Colum J Transnat'l

L 445 [1985]). The United States Supreme Court held in *Bass, Ratcliff & Gretton* v. *State Tax Commn.* (266 US 271) that a New York tax imposed on a British corporation for the privilege of doing business in New York through its branches here, and measured by the allocated income accruing from the business conducted inside and outside of New York in the preceding year, did not burden foreign commerce. Contrary to petitioner's suggestion, this decision is still viable (*see, Mobil Oil Corp.* v *Commissioner of Taxes*, 445 US 425, 438-439; *Barclays Bank Int'l* v *Franchise Tax Bd.*, ____ Cal Rptr. 2d ____ [May 11, 1992]).

Petitioner's claim that the methodology discriminates against foreign commerce (*see, Japan Line* v *County of Los Angeles*, 441 US 434, 444-445) rests on its concern that it will force petitioner to expend prohibitively large sums of money to undertake the accounting and property valuations necessary to comply, a burden not visited on United States corporations because their income and deductions are already computed in United States currency amounts. There may be occasion when proof of the cost of compliance warrants a finding that a State's tax laws discriminate against foreign commerce (*cf., Bibb* v *Navajo Frgt. Lines*, 359 US 520, 526). That, however, is not the factual circumstance presented here for the averment of petitioner's Financial Manager of Taxation that the cost of compliance would be nearly $1 million per year is sorely undermined by the fact that petitioner was able to promptly supply information to the Tribunal to reduce the deficiencies initially indicated.

Similarly unsupported is petitioner's contention that the tax contravenes United States' foreign policy as enunciated by the Federal Government (*see, Japan Line* v *County of Los Angeles, supra*, at 451). While the tax at issue obviously has a foreign resonance, there is no evidence that as a matter of foreign policy Federal uniformity with respect to state taxes on foreign corporations for the privilege of doing business in the taxing state in branch form has been deemed essential by the Federal Government (*see, id.*, at 448; *see also, Container Corp. of Am.* v *Franchise Tax Bd.*, 463 US 159, 194). To the contrary, while the US-UK Tax Treaty provides that income tax liability to the Federal

Government is to be calculated solely on the extent of petitioner's United States-based activity (as a consequence of which petitioner paid no Federal income taxes for the three tax years at issue [*see*, 26 CFR 1.11-1]), it does not so limit the State's taxing activity, except to require that such activity be, as previously observed, nondiscriminatory (*see*, *Wardair Canada* v *Florida Dept. of Revenue*, 477 US 1, 9).

Lastly, insofar as petitioner's contentions are predicated on the rationale advanced by the California Court of Appeals in *Barclays Bank Int'l* v *Franchise Tax Bd.* (232 Cal App 3d 1187), it suffices to note that this decision was recently reversed by the California Supreme Court (*Barclays Bank Int'l* v *Franchise Tax Bd.*, ____ Cal Rptr 2d ____ [May 11, 1992], *supra*). Accordingly, we conclude that there is insufficient evidence to establish that New York's worldwide net income apportionment method of franchise taxation discriminates against petitioner in foreign commerce or is an aberration of national policy where uniform national policy has been deemed essential.

Mikoll, J.P., Levine, Mercure and Harvey, JJ., concur.

ADJUDGED that the determination is confirmed, without costs, and petition dismissed.

ENTER:

/s/ Michael J. Novack
Michael J. Novack
Clerk

APPENDIX E

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
	:	
of	:	
	:	
REUTERS LTD.	:	DECISION
	:	
for Redetermination of	:	
Deficiencies or for Refund of	:	
Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for	:	
the Years 1977, 1978 and 1979.	:	

Petitioner Reuters Ltd., 1700 Broadway, New York, New York 10105 filed an exception to the determination of the Administrative Law Judge issued on February 22, 1990 with respect to its petition for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1977, 1978 and 1979 (File No. 800880). Petitioner appeared by Weil, Gotshal & Manges (Philip T. Kaplan, Esq. of Counsel). The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq. of Counsel).

Both parties filed briefs in this matter. Oral argument, at petitioner's request, was heard on September 26, 1990.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

Issues

I. Whether the Division of Taxation constitutionally applied Tax Law §§ 208 and 210 and the regulations at 20 NYCRR 3-2 and 3-8 in computing petitioner's franchise tax liability for the years in issue against an allocated worldwide entire net income base.

II. Whether computation of petitioner's franchise tax liability for the years in issue against an allocated worldwide entire net income base violated Article 24 of the US-UK Tax Convention (the "Treaty").

Findings of Fact

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.[1]

At all times relevant herein, the years 1977, 1978 and 1979 (the "audit period"), petitioner, Reuters Ltd. ("Reuters"), was a corporation organized in the United Kingdom engaged in the business of supplying news and economic and financial information by electronic means to newspapers, banks, insurance companies and others interested in such information. Reuters' operations were worldwide, doing business in approximately 80 countries, mainly through branch offices of the English company. The principal offices of the corporation were located in the United Kingdom, while its New York office was the main office in the United States. During the period in issue, Reuters was not incorporated in the State of New York.

Pursuant to the terms of the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of

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[1] For consistency, and ease of reference, we refer to the US-UK Tax Convention as the "Treaty." The Administrative Law Judge used both terms.

Fiscal Evasion with respect to Taxes on Income and Capital Gains (the "Treaty"), Reuters maintained a United States branch, with offices in New York. Its office was a "permanent establishment", defined by the convention as a "fixed place of business through which the business of an enterprise is carried on." (*Tax Convention*, Article 5[1]; Article 5[2][a].)

For purposes of the franchise tax imposed by section 209 of the Tax Law, Reuters is an "alien" corporation, i.e., a corporation "organized under the laws of a country other than the United States." (20 NYCRR 3-8.3.)

During the period in issue, Reuters filed corporation franchise tax reports with the State of New York and United States income tax returns of a foreign corporation with the Federal government. Said reports were also filed with the government of the United Kingdom. United Kingdom tax liability was computed against a basis comprised of income earned by Reuters from its operations throughout the world. The tax imposed by the United States Internal Revenue Code was computed against a basis of income, gain or loss attributable to United States sources only. For the purposes of this determination, such a computational basis will be referred to as "water's edge" income, which is in compliance with the specific provisions of the U.S.-U.K. Tax Convention. The New York franchise tax liability of Reuters was imposed against a basis comprised of allocated Federal taxable income plus all other income earned outside of the United States, as adjusted by specific deductions. These adjustments were made in accordance with the regulation at 20 NYCRR 3-2.3(9).

As stated above, Reuters filed corporation franchise tax reports for each of the calendar years in issue. For the year 1977, Reuters computed its New York liability against an allocated worldwide income base. The original return was prepared by Coopers and Lybrand which stated in an attached page that the return was true, correct and complete, based on all information relating to the matters required to be reported in the return. For the years 1978 and 1979, Reuters computed its New York tax liability

against only the United States source income. In 1981, Reuters amended its 1977 filing to conform to the subsequent reports, using the United States income base. For each of the years in issue, taxable net income on the corporation franchise tax reports reflected a loss.

The gross revenues of the United States permanent establishment represented a maximum of 15% of Reuters' worldwide gross revenues for each of the years in issue.

An audit was performed by the Division of Taxation between September of 1980 and September of 1983 covering the period in issue. Although all aspects of the corporation franchise tax reports for each year were analyzed, the only disputed issue was whether the Division was restricted by the tax convention from calculating Reuters' income for corporate income tax purposes by applying the three-factor formula (property/receipts/payroll) to worldwide income.

Although it was suggested that Reuters file using a worldwide basis for its entire net income, it chose to amend its 1977 corporation franchise tax report and file for each of the three years of the audit period based upon United States income alone. Therefore, for the year 1977, Reuters is claiming a refund of $30,011.00, representing the difference between tax recomputed using a United States basis of income (a loss) versus a worldwide basis as used in the computation of tax on the original 1977 report.

The Division of Taxation recomputed New York entire net income for each of the years in issue against a base of allocated worldwide income, gain, and loss. The Division computed 1977 franchise tax liability against the income base as originally reported. For the years 1978 and 1979, the Division used worldwide income as reflected in Reuters' published annual reports, since other sources were not provided by Reuters, despite requests by the Division.

On October 14, 1983, the Division issued to Reuters Ltd., three statements of audit adjustment and three notices of deficiency which set forth the following:

Period Ended	*Tax Deficiency*	*Interest*	*Total Due*
12/31/77	$ 814.00	$ 519.00	$ 1,333.00
12/31/78	$385,982.00	$212,614.00	$598,596.00
12/31/79	$464,407.00	$215,764.00	$680,171.00

Following a conference held on November 7, 1985, and based upon additional information provided by Reuters, additional tax due was recomputed for each of the years in issue, as follows:

Year	*Additional Tax Due*
1977	$ 973.00
1978	$50,609.00
1979	$44,586.00
Total	$96,168.00

Therefore, the amount of additional tax due remaining in dispute is $96,168.00. The additional information supplied by Reuters only 13 days after the informal conference included data on the worldwide net profit of Reuters, excluding foreign subsidiaries, and calculated the allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages. The information was sent by Michael Crombie, Taxation Manager of Reuters, to Ms. Regina Jaffe, conferee, on November 20, 1985. The letter stated, in pertinent part:

> "The attached schedules provide data on the worldwide net profit of Reuters Limited, excluding foreign subsidiaries and calculates the allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages."

An analysis was performed by Reuters to demonstrate additional costs which would be incurred were it to be directed to comply with the Tax Law and corporation tax regulations relating to the calculation of corporation franchise tax based on worldwide income. Reuters' analysis included a partial list of adjustments to local book income in nearly 80 countries including currency conversion, accounting methods, depreciation, compensation and fringe benefits, gains and losses on sales and exchanges of assets, and interest expenses and losses on transactions between related taxpayers. These would be Federal adjustments while for New York purposes Reuters would have to eliminate dividends and interest received from its subsidiaries, add back interest and other amounts attributable as carrying charges to subsidiary capital and eliminate 50% of any dividends from corporations which were not subsidiaries during the periods in issue. The study also calculated the costs of complying with tax filing requirements for the years 1977 through 1979 including an estimate of local costs of making book conversions, the cost of establishing a U.S. staff to supervise the work of overseas personnel in making conversions, and various estimated departmental costs. By way of summary, the analysis estimated a start-up cost for the accounting changes of approximately $86,000.00 and recurring annual costs of over $680,000.00 in order to calculate Reuters' New York entire net income in the manner desired by the Division pursuant to the New York State Tax Law and regulations promulgated thereunder. Additionally, the analysis indicated that Reuters would have to value its worldwide real property and tangible personal property at fair market value on a quarterly basis in order to properly calculate its New York business allocation percentage. Said process was projected to cost no less than $300,000.00 per year.

For each of the three years in issue, Reuters had a subsidiary, IDR, Inc., which was a New York corporation. Reuters held 99.5% of the voting stock of IDR, Inc. in the years 1978 and 1979 and 93.8% of the voting stock in 1977. For all three years, 100% of IDR, Inc.'s value was allocated to New York State.

Reuters did approximately 15% of its business in the U.S. during the period in issue. For 1977, Reuters reported a worldwide business allocation percentage for New York State of 9.3853%. (The amended return reported 56.0999% based on United States source income.) The 1978 Franchise Tax Report indicated a business allocation percentage of 53.689% and 60.515% for 1979. Subsequently, Reuters conceded business allocation percentages for 1978 of 10.19% and 1979 of 8.39%, using worldwide income as a denominator.

Opinion

We believe it useful to briefly review the relevant provisions of the New York Tax Law, the United States Constitution, and the Treaty as a preface to the analysis of the issues in this case.

Article 9-A of the Tax Law imposes a franchise tax on every domestic or foreign corporation for the privilege of doing any of the following: exercising its corporate franchise; doing business; employing capital; owning or leasing property in New York State in a corporate or organized capacity; or maintaining an office in New York State (Tax Law § 209[1]; 20 NYCRR 1-1.1).

The tax may be imposed upon entire net income or upon one of several alternative bases (Tax Law § 209[1]).

Entire net income is the "total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department" (Tax Law § 208[9]). From the starting point of Federal taxable income, the Tax Law provides that in computing entire net income, certain items are to be included and other items are to be excluded.

As relevant here, Tax Law section 208(9)(c) provides that "[e]ntire net income shall include income *within and without the United States*" (Tax Law § 208[9][c] [emphasis added]; 20 NYCRR 1-3.2[2]).

The Commissioner's regulations provide that in computing entire net income, Federal taxable income must be adjusted by adding to it "in the case of a taxpayer organized outside the United States, all income from sources outside the United States less all allowable deductions attributable thereto which were not taken into account in computing Federal taxable income" (*see*, 20 NYCRR 3-2.3[a][9]).

Article I, section 8, clause 3 of the United States Constitution gives Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States."

Article VI, clause 2 of the United States Constitution provides that:

> "This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

Article 24(2) of the Treaty provides that:

> "The taxation on a *permanent establishment* which a (United Kingdom enterprise) has in the other Contracting State (the United States) shall not be less favorably levied in that other State then the taxation levied on *enterprises of that other State carrying on the same activities*" (emphasis added).

Article 2(4) of the Treaty provides that for the purposes of Article 24, the Treaty "shall also apply to taxes of every kind and description imposed by each Contracting State, or by its political subdivisions or local authorities."

Article 5(2)(a) of the Treaty defines the term "permanent establishment" to include a "branch."

The Administrative Law Judge determined that the Division of Tax Appeals had jurisdiction in this case because the issue concerned the application of the statute to petitioner and not a challenge to the validity of the statute as enacted by the Legislature.

The Administrative Law Judge further determined that the application of the law and regulations by the Division of Taxation (hereinafter the "Division") to petitioner did not violate the Foreign Commerce Clause of the United States Constitution or the non-discrimination clause of the Treaty.

With regard to the Foreign Commerce Clause, the Administrative Law Judge concluded that the application of the tax to petitioner met the two stage analysis laid down by *Japan Line v. County of Los Angeles* (441 US 434, 60 L Ed 2d 336). First, the tax met the four part test applicable to interstate commerce, i.e., the tax was applied to an activity with a substantial nexus to New York State, the tax was fairly apportioned, the tax did not discriminate against interstate commerce, and the tax was fairly related to services provided by the State. Second, the tax satisfied the two inquiries added by *Japan Line* with regard to foreign commerce, i.e., that there was no enhanced risk of multiple taxation and that the tax did not impair Federal uniformity in an area where Federal uniformity is essential.

The Administrative Law Judge determined that the facts here could not be distinguished from those in *Bass, Ratcliff & Gretton v. State Tax Commn.* (266 US 271, 69 L Ed 282) in which the Supreme Court held that a United Kingdom company doing business in New York State through a branch was subject to New York franchise tax on the basis of allocated income.

With regard to the Treaty, the Administrative Law Judge determined a) that since the political subdivisions of the United Kingdom do not impose income taxes comparable to those imposed by the United States' state governments, the non-discrimination provision of the Treaty did not apply, b) that the legislative history of the Treaty indicates that it was not intended

to apply where the United Kingdom company was doing business in the United States in branch form rather than subsidiary form, and c) petitioner could have elected to do business in the United States in subsidiary form rather than branch form thus avoiding the consequences of the tax to which it now objects.

Petitioner asserts that the Administrative Law Judge erred and that the application of the law and regulations by the Division violates both the Foreign Commerce Clause and the nondiscrimination clause of the Treaty.

With regard to the Commerce Clause, petitioner asserts that "[t]he question is whether the Commerce Clause permits a state to employ formulary apportionment of worldwide income of a foreign-based multinational enterprise. That question is unaffected by the form (branch or subsidiary) in which the foreign-based multinational conducts its U.S. operations" (petitioner's brief at hearing, p. 27).

Petitioner asserts that New York's tax violates the Federal uniformity requirements of *Japan Line* because foreign policy is necessarily implicated where the taxpayer subjected to formulary apportionment of worldwide income is a branch or United States subsidiary of a foreign corporation such as petitioner.

Petitioner also asserts that the tax as applied to it is unconstitutional on the grounds of burdensome compliance.

With regard to the Treaty, petitioner asserts that during the years at issue it did business in New York through a branch and, thus, maintained a "permanent establishment" in the United States and the State of New York within the meaning of the Treaty.

Petitioner asserts that Article 24 of the Treaty applies to local taxes as well as to Federal taxes. Petitioner asserts that subdivision 2 of that Article forbids the use of the worldwide income

of petitioner whether or not apportioned within and without the state as the basis for New York taxation if a New York corporation, located entirely in New York and performing the same activities as petitioner's New York branch, would have paid a smaller tax.

The Division asserts that it is proper to determine petitioner's entire net income by including income from within and without the United States as required by section 208(9)(c) of the Tax Law and apportioning such income to New York through the application of the statutory formula. Imposition of the tax on this basis, argues the Division, is not violative of the Federal Commerce Clause and is not more burdensome on petitioner than the tax imposed on corporations transacting business in New York State on a similar basis.

We affirm the determination of the Administrative Law Judge for the reasons stated below.

The Administrative Law Judge and the parties concluded that the issue for resolution was the application of the tax, a matter within the jurisdiction of the Tribunal and the Division of Tax Appeals.

We deal first with the non-discrimination clause of the Treaty.

Article 24(2) of the Treaty provides that:

> "The taxation on a *permanent establishment* which a (United Kingdom enterprise) has in the other Contracting State (the United States) shall not be less favorably levied in that other State then the taxation levied on *enterprises of that other State carrying on the same activities*" (emphasis added).

The Administrative Law Judge determined that the clause was not applicable because the United Kingdom did not have a subnational tax similar to those imposed by the individual states of the United States. We find nothing in the Treaty which

conditions application of the nondiscrimination clause on the existence of symmetrical taxing systems in the United States and the United Kingdom. The purpose of the clause is to insure equal tax treatment of businesses engaged in similar activities by the contracting states and by their political subdivisions or local authorities.

With respect to whether the tax is discriminatory, petitioner asserts that "[t]he comparison mandated by the Treaty is between the [petitioner's] New York branch and a New York corporation performing the same activities as that branch" (petitioner's brief at hearing, p. 12).[2]

To determine the scope of activities to be used in measuring the income to be allocated, petitioner construes the Treaty phrase "carrying on the same activities" as referring to the activities of the permanent establishment, i.e., the branch, but not the activities of the corporation of which the branch is a part. In short, petitioner's interpretation would not consider the worldwide activities of petitioner.

We cannot agree. The tax imposed here is a corporation franchise tax measured in this case by income. The corporation here is petitioner. A corporation carrying out "similar activities" under the terms of the Treaty would be a New York corporation with a New York office and worldwide branch activities. That is the proper comparison for purposes of the Treaty. We see no tax

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[2] Petitioner offers an elaboration on this point in its brief at hearing as follows:

> "[t]he comparison necessary to test the application of the nondiscrimination Article is made by substituting for the (United States) branch of the non-resident (United Kingdom) corporation a (United States) resident company *related to the first company exactly as the branch is related* – i.e. through the common ownership and control of the (United Kingdom) corporation" (petitioner's brief at hearing, p. 12 [citing Gifford, *Permanent Establishments Under the Nondiscrimination Clause in Income Tax Treaties*, 11 Cornell Intl. L J 51, 61 fn 32] [(emphasis added)].

discrimination resulting from this comparison since a New York corporation operating worldwide through foreign branches would be taxed in the same manner as petitioner here, i.e., on the basis of apportioned worldwide income.

Instead of trying to obtain comparable treatment, petitioner is really asking that it be treated more favorably than a New York corporation organized in the same manner as petitioner, that is, that its branch be treated as if it were a subsidiary of a foreign parent. Since New York does not require or permit foreign corporations to file combined tax reports with New York corporations (20 NYCRR 6-2.5[b]), petitioner's interpretation would require that its branch be taxed as a separate entity without the inclusion of worldwide income. This treatment would clearly be more favorable than that accorded to New York corporations organized in the same manner as petitioner.

We deal next with whether the imposition of the tax by the Division violates the Commerce Clause.

To test the validity of a tax affecting foreign commerce, two additional considerations beyond those articulated in the doctrine governing the Interstate Commerce Clause come into play.[3] The first consideration is the enhanced risk of multiple taxation. The second consideration is the possibility that the state tax will impair Federal uniformity in an area where Federal uniformity is essential or will violate a clear Federal directive (*Container Corp. of Am. v. Franchise Tax Bd.*, 463 US 159, 77 L Ed 2d 545; *Japan Line v. Counts of Los Angeles*, *supra*).

Petitioner does not argue the multiple taxation issue but asserts only that imposition of the tax here prevents essential Federal uniformity. Petitioner's principal argument is that "foreign policy is necessarily implicated where the taxpayer subjected to

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[3] The parties agree that the four part test applicable to interstate commerce has been met.

formulary apportionment of worldwide income is a branch or U.S subsidiary of a *foreign* corporation" (petitioner's brief on appeal, p. 7).

Petitioner relies on the fact that the Supreme Court in *Container* refrained from addressing "the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents" (*Container Corp. of Am. v. Franchise Tax Bd., supra*, 77 L Ed 2d 545, 568 fn 26). Petitioner also points to the decision of the California Court of Appeals in *Barclays Bank Intl. v. Franchise Tax Bd.* (225 Cal App 3d 1342, 275 Cal Rptr 626) in which the Court, dealing with the same tax at issue in *Container* but applied to a foreign taxpayer, concluded that imposition of the tax violated the Commerce Clause of the Constitution. The combination of these two factors, urges petitioner, forms a basis for this Tribunal to reach a decision that imposition of the tax on petitioner here is unconstitutional because it impairs Federal uniformity.

We cannot agree.

A "state tax at variance with Federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear Federal directive" (*Container Corp. of Am. v. Franchise Tax Bd., supra*, 77 L Ed 2d 545, 571-572).

Imposition of the tax here violates no clear Federal directive. There is no assertion or evidence here that Federal tax statutes themselves provide the necessary preemptive force. Moreover, the Treaty (with the exception of the non-discrimination clause which we have determined is not violated by the imposition here) clearly does not affect the method of taxation employed by the states (*Container Corp. of Am. v. Franchise Tax Bd., supra*, 77 L Ed 2d 545, 573).

With regard to foreign policy, it appears that petitioner's position is that taxation of a branch or subsidiary of a foreign

corporation always "implicates foreign policy issues which must be left to the Federal Government."

We find no affirmative basis for petitioner's assertion.

We do not find the reservation of this issue by the Court in *Container*, relied upon by petitioner, an indication that state taxation of a subsidiary of a foreign corporation *per se* implicates foreign commerce in an unconstitutional manner. We believe it more prudent to rely on what analysis the Court did provide rather than to speculate on its response to issues it did not address.

In this context, the Court stated that the most obvious foreign policy implication of a state tax was the threat of possible retaliation by foreign governments, something the Court felt it had "little competence in determining . . . and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please" (*Container Corp. of Am. v. Franchise Tax Bd.*, *supra*, 77 L Ed 2d 545, 572).

Our competence on this subject is certainly no greater than the Court in *Container*; however, we fail to see how imposition of the tax on petitioner under the facts herein raises the threat of retaliation, nor are we presented with any evidence on the subject. In contrast, the Court in *Barclays* was presented with explicit evidence of retaliation. The Court in that case noted that: "[e]very single nation in the industrialized western world has sent letters to the United States government protesting the use of WWCR (Worldwide Combined Reporting) by American States" (*Barclays Bank Intl. v. Franchise Tax Bd.*, *supra*, 275 Cal Rptr 626, 638). The Court also pointed to retaliatory legislation passed in 1985 by Great Britain. British corporations have incurred a tax in New York similar to the instant imposition at least since 1924 (*see*, *Bass, Ratcliff & Gretton v. State Tax Commn.*, *supra*, 69 L Ed 282). Therefore, there has been plenty of time for retaliatory acts. Nonetheless, petitioner has failed to prove that any such acts have occurred.

Petitioner also asserts that the Administrative Law Judge erred in distinguishing the instant case from *Container* and *Barclays* on the grounds that petitioner here operated as a single entity through a branch and not as a unitary business operating through a subsidiary corporation. Petitioner asserts that the decision in *Bass*, relied on by the Administrative Law Judge, should not be viewed as persuasive case law because *Bass* is "a sixty-year old decision predating modern treaties and involving an entirely different and much less interconnected world economy and different political and economic climate" (petitioner's brief at hearing, p. 27), and that if *Bass* were dispositive of the issue, the *Container* Court would have reached its decision on that basis. We disagree with petitioner's rationale. *Bass* represents direct precedent from the United States Supreme Court sustaining the imposition of the New York franchise tax on a British company doing business in New York State on the basis of allocated income on the same basic facts as exist here. The principles enunciated by the Court in *Bass* retain their vitality (*see*, *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 US 425, 63 L Ed 2d 510, 521 [where the Court relied upon *Bass* to uphold a state's right to tax dividends from foreign subsidiaries]).

We note further that New York does not allow nor require foreign corporations to be included in combined reports (20 NYCRR 6-2.5[6]). The State thus avoids the fundamental issue of taxing a corporation which has contact with the state only through the activities of a subsidiary corporation, the principal issue in *Container* and *Barclays*.

Petitioner also asserts that the imposition of the tax violates the Commerce Clause because of the burden of compliance in its case. Again, petitioner relies on *Barclays* where the Court determined that foreign commerce is unconstitutionally interfered with if the effect of a state tax is to place an unreasonably high cost of compliance on taxpayers engaged in foreign commerce.

Petitioner asserts that the Administrative Law Judge erred by not giving "due weight" to facts concerning the cost of its

compliance as demonstrated by petitioner and not disputed by the Division and the testimony of petitioner's witness concerning the absence of "an accounting system that would permit recasting of accounting records in a manner that would conform with Federal and New York tax-reporting standards" (petitioner's brief on appeal, p. 5). We do not agree.

The Court in *Barclays* is clear to point out that costs alone are not enough to invalidate the tax. In essence, the Court dealt with the issue as an integral part of its conclusion that the California tax interfered with foreign commerce. We have determined that the tax as applied here does not interfere with foreign commerce and agree with the California court that cost alone is not enough to invalidate the tax.

In summary, we find the tax herein imposed does not violate the nondiscrimination clause of the Treaty nor the Foreign Commerce Clause of the Constitution.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Reuters Ltd. is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Reuters Ltd. is denied; and

4. The three notices of deficiency dated October 14, 1983, as modified at the conciliation conference, are sustained.

DATED: Troy, New York
MAR 21 1991

/s/ John P Dugan

John P. Dugan
President

/s/ Francis R Koenig

Francis R. Koenig
Commissioner

/s/ Maria T Jones

Maria T. Jones
Commissioner

APPENDIX F

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of REUTERS LTD. for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1977, 1978 and 1979.	:	DETERMINATION

Petitioner, Reuters Ltd., 1345 Avenue of the Americas, New York, New York 10105, filed a petition for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1977, 1978 and 1979 (File No. 800880).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on December 7, 1987 at 1:15 P.M., with all briefs filed by February 16, 1989. Petitioner appeared by Philip T. Kaplan, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation constitutionally applied Tax Law §§ 208 and 210 and the regulations at 20 NYCRR 3-2 and 3-8 in computing petitioner's franchise tax liability for the years in issue against an allocated worldwide entire net income base.

II. Whether computation of petitioner's franchise tax liability for the years in issue against an allocated worldwide entire net income base violated Article 24 of the US-UK Tax Convention.

FINDINGS OF FACT

1. At all times relevant herein, the years 1977, 1978 and 1979 (the "audit period"), petitioner, Reuters Ltd. ("Reuters"), was a corporation organized in the United Kingdom engaged in the business of supplying news and economic and financial information by electronic means to newspapers, banks, insurance companies and others interested in such information. Reuters' operations were worldwide, doing business in approximately 80 countries, mainly through branch offices of the English company. The principal offices of the corporation were located in the United Kingdom, while its New York office was the main office in the United States. During the period in issue, Reuters was not incorporated in the State of New York.

2. Pursuant to the terms of the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains (the "US-UK Tax Convention"), Reuters' maintained a United States branch, with offices in New York. Its office was a "permanent establishment", defined by the convention as a "fixed place of business through which the business of an enterprise is carried on." (*Tax Convention*, Article 5[1]; Article 5 [2][a].)

3. For purposes of the franchise tax imposed by section 209 of the Tax Law, Reuters is an "alien" corporation, i.e., a corporation "organized under the laws of a country other than the United States." (20 NYCRR 3-8.3.)

4. During the period in issue, Reuters filed corporation franchise tax reports with the State of New York and United States income tax returns of a foreign corporation with the Federal government. Said reports were also filed with the government of the United Kingdom. United Kingdom tax liability was computed against a basis comprised of income earned by Reuters from its operations throughout the world. The tax imposed by

the United States Internal Revenue Code was computed against a basis of income, gain or loss attributable to United States sources only. For the purposes of this determination, such a computational basis will be referred to as "water's edge" income, which is in compliance with the specific provisions of the U.S.-U.K. Tax Convention. The New York franchise tax liability of Reuters was imposed against a basis comprised of allocated Federal taxable income plus all other income earned outside of the United States, as adjusted by specific deductions. These adjustments were made in accordance with the regulation at 20 NYCRR 3-2.3(9).

5. As stated above, Reuters filed corporation franchise tax reports for each of the calendar years in issue. For the year 1977, Reuters computed its New York liability against an allocated worldwide income base. The original return was prepared by Coopers and Lybrand which stated in an attached page that the return was true, correct and complete, based on all information relating to the matters required to be reported in the return. For the years 1978 and 1979, Reuters computed its New York tax liability against only the United States source income. In 1981, Reuters amended its 1977 filing to conform to the subsequent reports, using the United States income base. For each of the years in issue, taxable net income on the corporation franchise tax reports reflected a loss.

6. The gross revenues of the United States permanent establishment represented a maximum of 15% of Reuters' worldwide gross revenues for each of the years in issue.

7. An audit was performed by the Division of Taxation between September of 1980 and September of 1983 covering the period in issue. Although all aspects of the corporation franchise tax reports for each year were analyzed, the only disputed issue was whether the Division was restricted by the tax convention from calculating Reuters' income for corporate income tax purposes by applying the three-factor formula (property/receipts/payroll) to worldwide income.

Although it was suggested that Reuters file using a worldwide basis for its entire net income, it chose to amend its 1977 corporation franchise tax report and file for each of the three years of the audit period based upon United States income alone. Therefore, for the year 1977, Reuters is claiming a refund of $30,011.00, representing the difference between tax recomputed using a United States basis of income (a loss) versus a worldwide basis as used in the computation of tax on the original 1977 report.

8. The Division of Taxation recomputed New York entire net income for each of the years in issue against a base of allocated worldwide income, gain, and loss. The Division computed 1977 franchise tax liability against the income base as originally reported. For the years 1978 and 1979, the Division used worldwide income as reflected in Reuters' published annual reports, since other sources were not provided by Reuters, despite requests by the Division.

9. On October 14, 1983, the Division issued to Reuters Ltd., three statements of audit adjustment and three notices of deficiency which set forth the following:

Period Ended	*Tax Deficiency*	*Interest*	*Total Due*
12/31/77	$ 814.00	$ 519.00	$ 1,333.00
12/31/78	$385,982.00	$212,614.00	$598,596.00
12/31/79	$464,407.00	$215,764.00	$680,171.00

10. Following a conference held on November 7, 1985, and based upon additional information provided by Reuters, additional tax due was recomputed for each of the years in issue, as follows:

Year	*Additional Tax Due*
1977	$ 973.00
1978	$50,609.00
1979	$44,586.00
Total	$96,168.00

Therefore, the amount of additional tax due remaining in dispute is $96,168.00. The additional information supplied by Reuters only 13 days after the informal conference included data on the worldwide net profit of Reuters, excluding foreign subsidiaries, and calculated the allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages. The information was sent by Michael Crombie, Taxation Manager of Reuters, to Ms. Regina Jaffe, conferee, on November 20, 1985. The letter stated, in pertinent part:

> "The attached schedules provide data on the worldwide net profit of Reuters Limited, excluding foreign subsidiaries and calculates the allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages."

11. An analysis was performed by Reuters to demonstrate additional costs which would be incurred were it to be directed to comply with the Tax Law and corporation tax regulations relating to the calculation of corporation franchise tax based on worldwide income. Reuters' analysis included a partial list of adjustments to local book income in nearly 80 countries including currency conversion, accounting methods, depreciation, compensation and fringe benefits, gains and losses on sales and exchanges of assets, and interest expenses and losses on transactions between related taxpayers. These would be Federal adjustments while for New York purposes Reuters would have to eliminate dividends and interest received from its subsidiaries, add back interest and other amounts attributable as carrying charges to subsidiary capital and eliminate 50% of any dividends from corporations which were not subsidiaries during the periods in issue. The study also calculated the costs of complying with tax filing requirements for the years 1977 through 1979 including an estimate of local costs of making book conversions, the cost of establishing a U.S. staff to supervise the work of overseas personnel in making conversions, and various estimated departmental costs. By way of summary, the analysis estimated a start-up

cost for the accounting changes of approximately $86,000.00 and recurring annual costs of over $680,000.00 in order to calculate Reuters' New York entire net income in the manner desired by the Division pursuant to the New York State Tax Law and regulations promulgated thereunder. Additionally, the analysis indicated that Reuters would have to value its worldwide real property and tangible personal property at fair market value on a quarterly basis in order to properly calculate its New York business allocation percentage. Said process was projected to cost no less than $300,000.00 per year.

12. For each of the three years in issue, Reuters had a subsidiary, IDR, Inc., which was a New York corporation. Reuters held 99.5% of the voting stock of IDR, Inc. in the years 1978 and 1979 and 93.8% of the voting stock in 1977. For all three years, 100% of IDR, Inc.'s value was allocated to New York State.

13. Reuters did approximately 15% of its business in the U.S. during the period in issue. For 1977, Reuters reported a worldwide business allocation percentage for New York State of 9.3853%. (The amended return reported 56.0999% based on United States source income.) The 1978 Franchise Tax Report indicated a business allocation percentage of 53.689% and 60.515% for 1979. Subsequently, Reuters conceded business allocation percentages for 1978 of 10.19% and 1979 of 8.39%, using worldwide income as a denominator.

CONCLUSIONS OF LAW

A. Since the issues involved in this case relate directly to the application of the New York Tax Law and regulations promulgated thereunder, it is necessary to first establish jurisdiction of the Division of Tax Appeals to hear and decide this matter. Although neither side has contested the jurisdiction to decide issues concerning the applicability of statutes and regulations to the instant facts, the parameters of the Tax Appeals Tribunal's scope of review should be clear at the outset. This scope has been described as follows:

"The Tribunal's enabling legislation does not extend our scope of review to determine the facial constitutionality of Tax Law statutes (*Fourth Day Enterprises*, Tax Appeals Tribunal, October 27, 1988); however, we may determine whether Tax Law statutes are constitutional as applied (*see, Matter of David Hazan, Inc.*, Tax Appeals Tribunal, April 21, 1988). From this authority it follows that we may determine whether the Commissioner's regulations are constitutionally valid, both facially - as in the instant case - and as applied (20 NYCRR 3000.11[e][3])." (*Matter of J.C. Penney Co., Inc.*, Tax Appeals Tribunal, April 27, 1989.)

Therefore, the issue of whether the application of the New York statutes and regulations are violative of specific provisions of the United States Constitution will be determined herein.

B. The United States Constitution gives Congress the exclusive authority to regulate United States commerce with foreign nations. (US Const, art I, § 8, cl 3.) Concurrent with the broad grant of authority over foreign commerce, Congress is also given the power to enter into treaties with these foreign nations. (US Const, art VI, cl 2.) A treaty, as the supreme law of the land, is binding on the States (*Hauenstein v. Lynham*, 100 US 483 [1879]), and treaty provisions will be liberally construed to effect their purpose. (*Neilson v. Johnson*, 279 US 607 [1928]; *Geoffrey v. Riggs*, 133 US 258 [1889]; *United States v. A.L. Burbank & Co., Ltd.*, 525 F2d 9, *cert denied* 426 US 934.) If a state law, and specifically a state-imposed tax, directly conflicts with a treaty provision, the terms of the treaty will prevail. (*Scandinavian Airlines System v. County of Los Angeles*, 56 Cal 2d 11 [1961], *cert denied* 368 US 899.)

The Division of Taxation recomputed Reuters' tax liability for the years 1977, 1978 and 1979 based upon the portion of its entire net income allocated within New York State by multiplying its business income by a business allocation percentage (Tax Law 210.3[a]) and its investment income by an

investment allocation percentage (Tax Law § 210.3[b]). The heart of this issue in the instant matter is the allocation of Reuters' entire net income, *i.e.*, its total net income from all sources (Tax Law § 210.9). The business allocation percentage is determined by taking the sum of the:

(a) percentage which the average value of real and tangible personal property within New York State bears to average value of all taxpayer's real and tangible personal property *wherever situated*;

(b) percentage which receipts earned within New York State bear to total receipts within and without New York State, weighted twice; and

(c) percentage which total wages, salaries and personal service compensation less compensation of general executive officers within New York State bears to total wages, salaries and personal services compensation within and without the State;

and dividing the sum by the number of percentages.

The Division of Taxation, following the computational method set forth in Tax Law § 210.3(a), calculated Reuters' business allocation percentage using worldwide figures gleaned from annual reports (these were the only figures available to the Division given Reuters' noncompliance with requests by the Division for better sources of information). The statute's references to the use of figures for property, wages and receipts "within and without" the State implies *all* sources, and the regulation at 20 NYCRR 3-2.3(a) supports such an interpretation with regard to Reuters, to wit:

> "In the case of a taxpayer organized outside of the United States, all income from sources outside the United States less all allowable deductions attributable thereto, which were not taken into account in computing federal taxable income." (20 NYCRR § 3-2.3[a][9].)

The question then becomes whether the Commissioner's application of the statute and regulations has violated the Foreign Commerce Clause of the Constitution by usurping Congress's complete authority in this area. It is determined that there has been no such violation or assumption in the instant action.

The case law in this area has been eloquently briefed by the parties and mention of it at this juncture is both essential and proper. In *Complete Auto Transit, Inc. v. Brady* (430 US 274 [1977], *reh denied* 430 US 976) the application of a Mississippi tax on the "privilege of doing business" within Mississippi to the activity in interstate commerce of a motor carrier in transporting an out-of-state manufacturer's automobiles between points in the state was challenged as violative of the Constitution's Commerce Clause. The Court, finding the tax not to be violative of the Commerce Clause, reiterated the four elements of a successful defense of a Commerce Clause challenge, *i.e.*, that the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state.

The tax imposed against Reuters meets these requirements. Reuters, doing business in New York, has a nexus with the state sufficient to subject it to the franchise tax. The tax is fairly apportioned, by application of allocation percentages to the specific tax base, reflecting the degree of petitioner's business transacted in New York. The franchise tax does not *per se* discriminate against interstate commerce, and, as applied in this matter, the tax is fairly related to services provided to Reuters by New York State.

However, when a state seeks to tax the instrumentalities of foreign commerce, two additional considerations, beyond those set forth in *Complete Auto*, must be weighed. (*Japan Line, Ltd. v. County of Los Angeles*, 441 US 434 [1979].) The first is the enhanced risk of multiple taxation, and the second is whether the state tax impairs federal uniformity in an area where federal uniformity is essential.

In *Japan Line*, the County of Los Angeles and other levied property taxes on large cargo shipping containers that were temporarily within the state. The containers were owned by Japanese shipping companies and had their home ports in Japan, where they were subject to property taxes. The containers were moved on the companies' ships and both the containers and the ships were used exclusively for hire in the transportation of cargo in foreign commerce. The Court refused to decide the case solely on the four tests enunciated in *Complete Auto* and ruled that the additional considerations of multiple taxation and federal uniformity must be examined as well. The California tax in *Japan Line* was found to violate the Commerce Clause since it resulted in multiple taxation of instrumentalities of foreign commerce and prevented the United States from "speaking with one voice" in regulating foreign trade. It is noted that the ad valorem tax involved in *Japan Line* was a property tax not an income tax and that the taxation of such containers was the subject of a U.S.-Japan treaty, viz., the Custom Convention on Containers, which sought to reflect a national policy to remove impediments to the use of containers as "instruments of international traffic." Thus, the California tax frustrated the goal of federal uniformity and invited retaliation from Japan, which did not tax U.S. containers. Also, since the containers were taxed in Japan, the California tax was clearly enhancing the risk of multiple taxation.

Petitioner argues that the franchise tax imposed against Reuters Ltd. is unconstitutional as a violation of the Foreign Commerce Clause because it cannot survive the scrutiny required by the second test set forth in *Japan Line*. Relying on the U.S.-U.K. Tax Convention, and referring specifically to Article 24, petitioner suggests that the tax as imposed implicates foreign policy issues and/or violates a clear federal directive, *i.e.*, prevents federal uniformity in the area. This issue will be dealt with as part of the discussion of the Tax Convention below.

Petitioner did not address itself to the issue of multiple taxation presumably because the U.K. allows a credit for income taxes paid abroad, rendering the risk of multiple taxation a moot issue herein.

Later cases have discussed the *Complete Auto* and *Japan Line* tests in the context of unitary businesses. Although the reasoning in these cases is thought provoking and somewhat analogous to the instant case, none squarely address the circumstances of an alien corporation doing business in branch form in a state.

In *Container Corporation of America v. Franchise Tax Broad* (463 US 159, *reh denied* 464 US 909) the Court examined a corporate franchise tax imposed by California on income, employing a unitary business principle and formula apportionment in applying that tax to corporations doing business both within and without the state. Like New York, California applied a three-factor formula to apportion the income of the unitary business (payroll, property and sales). The Court found the application of the unitary business principle proper; that the use of the three-factor formula to apportion income was not violative of the constitutional requirement of fair apportionment (from *Complete Auto*); and that the tax did not violate the Foreign Commerce Clause of the Constitution.

The *Container* case reaffirmed the general rule that under the Due Process and Commerce Clauses a state may not tax value earned outside its borders when imposing an income tax. This is precisely what Reuters claims New York is doing in the instant matter. But *Container* recognized that it is not always possible to make precise territorial allocations when businesses operate across state lines. Therefore, the Court held that the Constitution imposes no single formula for apportionment on the state. (*Id.* at 164.) Further, the Court held that the taxpayer had the burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed. (*Id.* at 164).

In this case, Reuters operated as a single enterprise with its headquarters in the United Kingdom. It operated branches in approximately 80 countries during the audit period, each of which collected and sold news, financial information, etc. to various types of customers (Finding of Fact "1"). Reuters does not present the unitary business problem which appeared in *Container Corporation of America v. Franchise Tax Board*

(*supra*), *Barclays Bank Int'l. v. Franchise Tax Board*, (Cal Super Ct, June 16, 1987, Paras, J.) and *Colgate Palmolive Co. v. Franchise Tax Board*, (Cal Super Ct, December 12, 1988, Gardner, J.). Further, New York State was not a unitary business jurisdiction during the audit period and the income of an alien parent or subsidiary would not have been considered in the calculation of entire net income. (*See* 20 NYCRR § 6-2.5[b].)

Rather, this case closely resembles *Bass, Ratcliff and Gratton, Ltd. v. State Tax Commission* (266 US 271 [1924]), in which the Supreme Court held that Bass Ratcliff, a British ale manufacturer, doing business in New York State through a branch which only operated as a sales office, was subject to the New York franchise tax for the privilege of doing business in the State. The tax was not defined as a direct tax on allocated income but a tax on the privilege of doing business in a given year measured by the allocated income accruing from the business in the preceding year.

The Court in *Bass Ratcliff* succinctly described the scenario of an alien corporation doing business in New York:

> "So in the present case we are of opinion that as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places – the process of manufacturing resulting in no profits until it ends in sales – the State was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business." (*Id.* at 282).

The business of Reuters can not be distinguished. Its New York branch collected and disseminated news etc. as an inextricable cog in the international news agency mechanism which was Reuters Ltd. Its income during the audit period was derived from worldwide operations of approximately 80 branches, all comprising one enterprise, Reuters Ltd. Just as in *Bass Ratcliff*,

the State of New York was justified in attributing to New York a just proportion of the profits earned from its worldwide business operations.

Although the *Container* court was dealing with a unitary business involving overseas subsidiaries, its rules of fair apportionment are pertinent to the Reuters facts. In *Container* the Court said that the formula for apportionment must have internal consistency so that if it were applied by all jurisdictions it would result in no more than all of the unitary business's income being taxed. (*Container Corp. of America v. Franchise Tax Board*, *supra*, at 169.) It also said that there must be external consistency as well, *i.e.*, the factors used in the formula must actually reflect a reasonable sense of how income is generated. (*Id.* at 170).

The fact that an apportionment formula may result in taxation of some income that did not have its source in the taxing state is not fatal, but the formula would not withstand the Court's scrutiny if the taxpayer showed that the income attributed was out of all proportion to the business transacted in that state. (*Id.* at 170.) Further, the three-factor formula of payroll, property and sales has been approved by the Court. (*Butler Bros. v. McColgan*, 315 US 501 [1942].) Given these rules, it is found that the three-factor apportionment formula used by the Division was fair and not out of proportion to the business transacted by Reuters in New York for the years in issue; at least Reuters has not shown that such apportionment was out of all proportion to the business transacted in the State. The fairness of those percentages discussed in Finding of Fact "13" was not questioned by Reuters and their proximity to the percentage reported by Reuters on its original 1977 report indicate that they were fair estimations.

What was questioned was whether the apportionment formula resulted in discrimination against foreign commerce. Reuters' strongest arguments concern the United States - United Kingdom Income Tax Convention and the "ostensible neutrality" of the tax statutes and regulations which impose the tax on

alien taxpayers using an allocated worldwide entire net income. However, before reaching those two issues, two recent California cases which have found California's unitary taxation theory unconstitutional should be examined.

The first case is *Barclays Bank Int'l. v. Franchise Tax Board* (*supra*) which involved a foreign parent corporation whose foreign subsidiary did business in California, both directly and through a California subsidiary. The Franchise Tax Board determined that this was a unitary business and computed income tax using the worldwide combined reporting method ("WWCR") even though 98.5% of the income of the unitary group was derived from sources outside the U.S. and only 1.5% of the unitary income was attributable to California. The court found that the WWCR method imposed an impermissible burden on foreign commerce and thus violated the Due Process Clause of the U.S. Constitution. Also, the court found that since federal uniformity was essential, the case did not meet the uniformity test in *Container*. The Court ruled that the arm's length/separate accounting method, with all its flaws and imperfections, is utilized by the Internal Revenue Service and by all nations of the world and does not unfairly and systematically discriminate against foreign nationals and should have been used in *Barclay's*.

Reuters analogizes itself to Barclay's Bank with particular emphasis on the alleged impossibility of compliance with the unitary tax requirements. As in *Barclays*, Reuters claims that it was discriminated against because only foreign multinationals are placed in the position of foregoing available New York tax benefits, and paying higher taxes; or spending a million dollars annually to file a correct New York franchise tax report; or discontinuing business in New York altogether.

In *Colgate Palmolive Co. v. Franchise Tax Board* (*supra*), the Franchise Tax Board imposed the franchise tax on Colgate Palmolive Co. which had a controlling interest in 75 foreign subsidiaries. The Franchise Tax Board used the WWCR method of accounting in calculating Colgate's tax, which the taxpayer paid and then filed for refund. The trial court judge ruled that

Container was not a reliable precedent because that case hinged on the government's failure to take a position on the issue of a state's right to use a unitary taxation scheme. The judge noted that since the *Container* decision, the President had instructed the Secretary of the Treasury and Attorney General to pursue the policy of arm's length/separate accounting for calculation of a multinational's in-state income. The judge also noted the executive's authority to establish national policy without the consent of the legislature and that too much should not be made of Congress's inaction on the unitary tax issue. He claimed that if Congress wished to express an opinion contrary to that of the executive, it easily could have done so.

Neither of these cases supports Reuters' petition in this matter. First, as stated above, the instant case does not concern the unitary business issue. There was no effort by the State of New York to combine the income of a Reuters' subsidiary or parent having no connection to or nexus with the State. The Division correctly noted that Reuters was a single, incorporated entity engaged in the business of media services throughout the world. Reuters did not conduct its New York business through a subsidiary but through a branch and New York taxed only that portion of its income allocable to New York. It did not combine the incomes of several related corporations as was the case in *Barclays* and *Colgate-Palmolive*. In fact, even if there were a case where New York might permit or require the combination of income from domestic subsidiaries of a multinational parent, items of income, gain and/or loss attributable to alien corporations would not be included. (*See* 20 NYCRR § 6-2.5[b].) The business of Reuters is very closely analogous to *Bass, Ratcliff and Gretton v. State Tax Commn.* (*supra*) and it would be a mistake to confuse it with a unitary business involving separate corporations.

However, the issues raised in *Container* and *Japan Line* and reexamined in *Barclays* and *Colgate-Palmolive* with regard to multiple taxation and federal uniformity must be discussed.

From the facts presented, there does not seem to be a problem of multiple taxation. Petitioner's own witness testified that there

is no taxation by political subdivisions within the United Kingdom and therefore the issue of symmetry does not exist. On the basis of the record, if all countries taxed Reuters on its apportioned worldwide net income it would not surpass the total amount of tax due. Further, the same witness conceded that Reuters would receive a credit against United Kingdom tax for all such foreign taxes paid.

Moreover, New York's taxing scheme for alien corporations does not deprive the United States from speaking with one voice. This is not a unitary situation where New York seeks to tax income of related companies without a rational apportionment formula. The instant case features State taxation of an alien entity with worldwide operations some of whose income must be fairly apportioned to New York. Where a company chooses to enter a taxing jurisdiction like New York with full knowledge of its tax laws and chooses to do business in a form with less than the most advantageous tax position, it must have a reason for so conducting its business.

For whatever reason, Reuters chose not to form a subsidiary corporation whereby it would have achieved its goal of arm's length/separate accounting treatment given New York's rule against combining alien income. (20 NYCRR 6-2.5.) It is noted that Reuters had a New York subsidiary, IDR, Inc., for all years in the audit period and had knowledge of the advantages of doing business as a New York subsidiary corporation. Reuters, however, chose to do business as a branch in New York State. "Having elected to conduct their business under this format, and having reaped the benefits thereof, [Reuters] now seek[s] to avoid any disadvantage arising out of the selected format. There is nothing irrational about the [Division's] determination which has the effect of binding the taxpayers to the form of business chosen by them." (*107 Delaware Associates v. New York State Tax Commission*, 99 AD2d 29 [Casey, J., dissenting], *revd on dissenting opn below* 64 NY2d 935; *Matter of Tops, Inc.*, Tax Appeals Tribunal, November 22, 1989.) Petitioner's voluntary, informed choice waived arm's length/separate accounting treatment and subjected all its income to the New York

apportionment formula. To limit Reuters' income to that earned in the United States would be a distortion of its true New York earnings and create a misconception of its true business operations.

In *Colgate-Palmolive* the court held that the WWCR method frustrated the ability of the Federal government to "speak with one voice" because:

(1) it impermissibly interfered with the conduct of foreign affairs by the executive branch of the Federal government;

(2) it caused conflicts between the United States and foreign nations and led to the adoption of retaliatory legislation; and

(3) it contravened established federal policy in the field of foreign affairs.

However, when those factors are applied to the situation in Reuters, where one entity was doing business in branch form, it is evident that there was no threat to federal uniformity. The Division seeks to tax only that portion of income allocable to New York in relation to the entire net income of the entity. In this case it just happens to be international. If allocated and adjusted properly, New York only receives tax on that income earned in this State. To compare its New York income to its Federal source income clearly would be a distortion of the percentage of the business's income attributable to New York State. The Federal government chooses to utilize the arm's length/separate accounting method as a mirror image to the treatment of U.S. companies by the United Kingdom. However, nothing in the U.S.-U.K. Tax Convention, U.S. Constitution or State law prohibits a political subdivision from using an allocation of worldwide net income. As stated above, to use the Federal figures in the instant situation would have created a fiction, not a fair portrayal of Reuters' actual income which should have been apportioned to New York.

The threat of retaliatory legislation is not applicable here. There is no income taxation of U.S. entities by U.K. political

subdivisions. If the U.K. wished to allow its political subdivisions to tax the income of multinationals it could do so and such an act would not be retaliatory, rather it would place U.K. political subdivisions on an even footing with their U.S. counterparts. However, if the U.K. sought to impose the WWCR method on U.S. corporations that would contravene the U.S.-U.K. Tax Convention. The New York regulation, on the other hand, does not contravene the U.S.-U.K. Tax Convention or Federal policy.

C. The U.S.-U.K. Tax Convention, signed on December 31, 1975 and entered into force on April 25, 1980 (U.S.-U.K. Income Tax Convention, 1980-81 C.B. 394 *et seq.*) was discussed at length by both parties in their briefs. The critical provision is Article 24-*Nondiscrimination*, which stated, in part, as follows:

> "(1) Individuals who are nationals of a Contracting State and who are residents of the other Contracting State shall not be subjected in that other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected."
>
> (2) The taxation on a permanent establishment which an enterprise of a *Contracting State* has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities." (Tax Convention, 1980-81 C.B. 414.)

Although it is conceded that Reuters operated a permanent establishment in the U.S., defined in Article 5(2) as a branch or office, the application clearly relates to the treatment of corporations by the U.S. and U.K., since the income taxation by the states bears no counterpart in the U.K. How can one say that a tax is not more or less favorably levied when there is no symmetry of taxation in both countries? The answer is that such a comparison is not possible.

The Division of Taxation argues that the Senate's refusal to ratify Article 9(4) relating to the prohibition on political subdivisions from taxing the income, deductions, receipts or outgoings of a "related enterprise" establishes, at least tacitly, an acceptance of WWCR and the unitary theory. This issue does not need to be addressed except to the extent it affects the instant factual situation, which it does not. New York does not seek to tax the income of a *related* entity but the *same* entity, wherever earned. By doing so it has not breached the terms of the treaty or usurped the Federal government's authority in this area.

The legislative history cited by the Division and the Senate's ultimate reluctance to endorse a prohibition on unitary taxing schemes by states, *i.e.* its reservation with regard to Article 9(4), clearly indicate that the Reuters scenario was not one which the treaty was intended to prohibit.

The Senate Executive Report No. 95-18 (1980-81 C.B. 411) sets forth explanations of the various articles of Treaty. With regard to Article 9 and the limitation on state taxation, it states, in pertinent part, as follows:

> "*Explanation of Limitation.* — The treaty provision prevents a state from extending the unitary method through this combined reporting system to related foreign enterprises where the enterprise doing business in the state is either a British enterprise or is controlled directly or indirectly by a British enterprise.
>
> * * *
>
> However, that state may take into account the income and assets of any other branches of that corporation, wherever located, because a corporation is considered to be a single enterprise regardless of how many separate branches or businesses it has." (1980-81 C.B. 420.)

Further, the technical explanation of the treaty by the Treasury Department (1980-81 C.B. 455) discussing Article 9(4), recognized

the difference between the unitary business and single enterprise and noted the alternative tax treatment of the latter:

> "Because a corporation is considered a single enterprise regardless of how many branches it has, a state may take into account the income and assets of all branches of that corporation, wherever located." (1980-81 C.B. 162.)

Thus, the Division has successfully illustrated that the Treaty did not intend to prohibit New York from imposing a franchise tax against Reuters against a base of its worldwide income.

Reuters argues that it was discriminated against in contravention of Article 9(2) because of the costs of compliance with what it terms "ostensibly neutral" tax statutes and regulations, *i.e.*, those that read as if they treat all taxpayers equally but, in fact, do not.

Reuters submits that the cost of compliance for an alien taxpayer outweighs the tax advantages of no complying. An affidavit submitted post hearing by Michael J. Canty, Financial Manager/Taxation of Reuters, estimated start-up costs for accounting changes alone of $86,000.00 and a recurring annual cost of $680,000.00 for calculating Reuters' New York entire net income in accordance with New York law and regulations. Additionally, the cost of valuing Reuters' assets throughout the approximately 80 countries in which it operated branches was estimated to be $300,000.00 per year.

Although the Division did not contest the accuracy of these estimates, it is noted that Reuters did file its original 1977 corporation franchise tax report using worldwide income figures, and the return was prepared by the accounting firm of Coopers & Lybrand which signed a declaration that the return was a "true, correct and complete return based on all the information relating to the matters required to be reported in this return . . ." The cost of compliance was not raised as an issue.

Further, after the conference held on November 7, 1985, Michael Crombie, a Taxation Manager for Reuters, sent a letter to the conferee, Ms. Regina Jaffe, dated November 20, 1985 (see Finding of Fact "10") which included worldwide net profit data requested at conference. Therefore, in 13 days Reuters was able to assemble worldwide figures without incurring those costs estimated by Mr. Canty.

The ability of Reuters to file the 1977 return and to provide figures to the conferee strongly suggests that its estimated costs of compliance are greatly exaggerated and not a burden on foreign commerce.

As mentioned above, Reuters was well aware of the hazards of doing business in New York as a branch as opposed to a subsidiary and it chose to be treated as such. The fact that it is not as advantageous as other forms of business is not a ground for finding the New York statute or regulations unconstitutional as applied.

D. There was discussion of *Zurich Insurance Co. v. New York State Tax Commission* (144 AD2d 202) by both parties in their briefs. In *Zurich*, the court found that the New York branch of a foreign bank qualified for treatment as a separate taxable entity. However, New York Insurance Law § 4103(b) requires that certain assets must be maintained by the insurance company for the protection of it policyholders. The court felt that this placed the branches in the same stead as a corporation formally incorporated in New York. Without reaching the inapposite facts of that case, it suffices to say that Reuters is not engaged in a regulated industry subject to special taxation. The fact that New York treats other more stringently regulated businesses differently, *i.e.* Article 33 corporations, does not impact on its taxation of a branch office of Reuters, an Article 9-A company. Nor is its taxation of insurance companies relevant to the constitutional application of the law and regulations in the instant matter.

E. For all of the reasons set forth above, the petition of Reuters, Ltd. is denied and the three notices of deficiency dated

October 14, 1983, as modified at conference (see Finding of Fact "10") are sustained, together with such additional interest as may be due and owing.

DATED: Troy, New York

FEB 22 1990

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE

APPENDIX G

Judgment of March 30, 1973, Finanzgerichte in Dusseldorf (tax trial court), 10 Entenscheidugen der Finanzgerichte (EFG) 509 (F.R.G.) (English translation)

Transfer Tax
Antidouble Tax Treaty

Allocation of working capital to a domestic branch of a Japanese bank

Fiscal Court Dusseldorf, decision of March 30, 1973 III 1236/71, annotation - legally binding.

The fact that furnishing a nonindependent domestic branch of a Japanese credit institute with so-called endowment funds is not subject to corporate tax does not contravene the prohibition of discrimination against permanent establishment contained in the Antidouble Tax Treaty with Japan.

The Antidouble Tax Treaty with Japan, Art. 24 para. 2 and 4; Transfer Tax Act § 2 para. 1 no. 6; Financing Act § 10 para. 1 phrase 2, § 53 para. 2 no. 4.

Plaintiff is a stock corporation established under Japanese law. Since 1971 it has operated a branch in Germany registered in the register of companies. This branch was furnished with a so-called endowment fund in the amount of DM 5 million. The opening balance of the branch shows this endowment fund on the minus side of the balance sheet, and on the plus side it shows a credit in the same amount with a German bank.

Defendant accepted the allocation of investment and working capital to a domestic branch to a foreign stock corporation, and made this procedure subject to corporate tax. - Plaintiff claimed, among other things, the allocation of the endowment fund was not subject to corporate tax, because § 2 para. 1 no. 6 of the Antidouble Tax Treaty with Japan of April 22, 1966, was no longer applicable. This would arise from the prohibition of discrimination against permanent establishments, for the domestic branch of a foreign corporation was not to be compared with the domestic corporation but only with the domestic branch of

a domestic corporation. It was not, so it was claimed, possible to derive the tax liability from § 53 para. 2 no. 2 Credit Act of July 10, 1961 (Federal Law Gazette 1961 I, p. 881) - Credit Act.

From the legal arguments:

The complaint is not substantiated. Defendant was justified in affirming the conditions of the fiscal status of § 2 para. 1 no. 6 Transfer Tax Act. Plaintiff is a foreign stock corporation and has allocated investment and working capital to its nonindependent domestic branch.

Although the conditional phrase "even if it were legally independent" is somewhat ambiguous, the legislator intended to link the fiscal status of § 2 para. 1 no. 6 Transfer Tax Act primarily to nonindependent domestic branches of foreign stock corporations; for if the domestic branch of foreign stock corporation is an stock corporation, § 2 para. 1 no. 6 Transfer Tax Act does not apply, instead the general provisions of § 2 para. 1 nos. 1 to 5 and § 3 Transfer Tax Act will apply during the duration of validity of the applicable Transfer Tax Act. The fiscal status of § 2 para. 1 no. 6 Transfer Tax Act has correspondingly been adapted to the legal position of the nonindependent branch. Since, with respect to these domestic branches, corporate laws and, at the same time, capital as a balance sheet item rendering information as to origin of the corporate assets (Wuhne, Balancing of Accounts and Accounting Policy, 1972, p. 20), only apply to the foreign place of business of the stock corporation and, therefore, do not come under domestic fiscal jurisdiction, the terms "corporate laws" and "capital" did not apply as characteristics of the fiscal status. Instead, it was necessary to substitute a characteristic which, from an economic point of view, came very close to the above terms, for it clearly had been the legislator's desire to include nonindependent branches in the overall corporate tax system. In this respect, the legislator decided on applying the term allocation of investment and working capital.

The fact that funds were allocated clearly emerges from the fact that the Japanese stock corporation made available to its branch the amount of DM 5 million in the form of a credit (debt) obtained from a German bank. It may be an open question

whether the investment and working capital is to be seen only as a comprehensive term for business assets which, if the branch operated as a business (§ 1-7 Commercial Code), would appear on the plus side of the balance sheet (§ 39 para. 2 Commercial Code) (narrow decision of the Reich Financial Court of October 14, 1930, Reich Tax Law Gazette 1930, p. 766) or as any additional strengthening of the branch's economic force. In case of litigation the working capital is allocated, even when taking into consideration the Reich Financial Court's narrow interpretation of the law, because the debt to the German bank constitutes an asset item and also was carried as an asset on the branch's initial balance sheet. The allocation of initial capitalization, the so-called endowment fund, to the plaintiff's domestic branch, therefore, satisfies the fiscal status of § 2 para. 1 no. 6 Transfer Tax Act (also Bellstedt: Taxation of International Corporations, 3rd ed. 1973, p. 111).

Nor does the prohibition of discrimination against permanent establishments of Art. 24 para. 2 Antidouble Tax Treaty with Japan conflict with the tax liability, which, according to Art. 24 para. 4 applies to taxes of any type and designation and, therefore, also to corporate tax. According to Art. 24 para. 2 of the Antidouble Tax Treaty with Japan, the taxation of a permanent establishment operated by a corporation of a contracting state in another contracting state may not be less unfavorable than that of a corporation of the other contracting state, said corporation being engaged in similar business activities. Accordingly, the taxation of the Japanese establishment in the Federal Republic of Germany must be compared with the taxation of a permanent establishment in this country.

What type of legal form the domestic companies to be compared must have, depends on the legal form of the Japanese corporation. This legal form must be ascribed to the nonindependent permanent establishment within the meaning of Art. 24 para. 2 of the Antidouble Tax Treaty with Japan, for if the foreign corporation supporting the domestic establishment is a stock corporation, the corporate assets cover only to a limited extent the transactions of the domestic establishment. In this respect, the activities of the domestic establishment (of a foreign

stock corporation) are similar to that of a foreign stock corporation. Therefore, the banking transactions of a foreign stock corporation (which, with respect to the plaintiff's branch, are described in greater detail in the register of companies) must be considered as being a "similar activity" within the meaning of Art. 24 para. 2 of the Antidouble Tax Treaty with Japan.

The required comparison of the plaintiff's domestic establishment with a domestic stock corporation engaging in banking transactions does not result in a discrimination against the domestic establishment by virtue of the contested corporate tax demand.

Bellstedt's opinion that the application of § 2 para. 1 no. 6 Transfer Tax Act was a discrimination to all intends and purposes, however, does not apply, because this provision had originally been aimed at discrimination (loc. cit. p. 121). Admittedly, it is the purpose of this provision to avoid that a stock corporation with headquarters abroad and independent and nonindependent branches in Germany enjoys a corporate tax advantage (Boruttau-Schadeck, Transfer Tax, 2nd ed.1964, section 17 p. 95; Egly, Transfer Tax Textbook, 2nd ed. 1968, section 34 p. 135; Bellstedt loc. cit. p. 106). The avoidance of an advantage is not quite the same than that of a disadvantage. In individual cases, this can result in discrimination, for the fiscal status of § 2 para. 1 no. 6 Transfer Tax Act is more extensive the sum of § 2 para. 1 no. 1 - 5 and § 3 Transfer Tax Act. From this one cannot conclude that § 2 para. 1 no. 6 Transfer Tax Act is aimed at discrimination and that, for all intends and purpose, it should not apply if there is an international prohibition of discrimination. In the event that § 2 para. 1 no. 6 Transfer Tax Act applies only to domestic branches of foreign stock corporations and not to domestic stock corporations, this does not constitute discrimination (unlike Bellstedt, loc. cit., p. 121). Whether there is discrimination cannot be determined on the basis of the isolated consideration of § 2 para. 1 no. 6 Transfer Tax Act, but this must emerge from the overall consideration of all provisions of German corporate tax law. In this respect, one must take into consideration that domestic stock corporations are subject to the

economically comparable fiscal status of § 2 para. 1 nos. 1-5 and to § 3 Transfer Tax Act. Only when the fiscal burden arising from the corporate fiscal status is higher than the tax burden which applies under § 2 para. 1 no. 6 Transfer Tax Act, the prohibition of discrimination applies (decree of the Ministry of Finance of the State of North Rhine-Westphalia, p. 5100 - 1 - VC 2 of January 28, 1963, tax abatement Transfer Tax Act § 2 no. 8).

The determination of the tax, which the defendant had based on § 2 para. 1 no. 6 Transfer Tax Act, does basically not exceed the amount that would have applied to a domestic stock corporation under the same fiscal status based upon § 2 para. 1 no. 6 Transfer Tax Act. A domestic stock corporation would have had to provide its initial capitalization through deposits made by stockholders, i.e., by means of considerations for the initial acquisition of corporate rights; the fiscal guidelines would have been these deposits (§ 2 para. 1, § 8 phrase 1 no. 1a Transfer Tax Act). It remains an open question whether the amount of initial capitalization arose from the requirements stipulate by the Credit Control Authority or from an independent decision made by the plaintiff. In any case, the plaintiff provided such an initial capitalization of guaranteed equity capital and, on the basis of the principles relating to equity capital and the liquidity of credit institutes decreed on January 20, 1960 (bulletin 1/69, Federal Gazette no. 17 of January 25, 1969, p. 2 column 2), based on § 10 para. 1 phase 2 Financing Act, would have given itself the opportunity to grant credits up to 18 times the amount of is equity capital to commercial establishments, private and credit institutes, or to purchase interests. The allocation of endowment funds to the plaintiff's branch, therefore, corresponds to an allocation of equity capital to a domestic stock corporation which is active in the banking business.

APPENDIX H

Minister of the Economy, of Finance and of the Budget / Generali-Assurances Generales de Trieste et Venise

Session of October 28, 1983
Reading of November 18, 1985

THE FRENCH REPUBLIC
IN THE NAME OF THE FRENCH PEOPLE

Le Conseil D'Etat Sitting as a Court
(Judicial Section 7th & 9th
Sub-Sections Sitting Together),

Concerning the Report of the 7th Sub-Section
of the Judicial Division.

Given the appeal, registered with the Secretariat of the Trial Division of the Conseil D'Etat on May 16, 1983, entered by the Minister of the Economy, of Finance and of the Budget and requesting that the Conseil D'Etat:

1. cancel the judgment of the administrative court of Paris, dated December 18, 1982, which had accorded the French branch of the Italian corporation, "Generali-Assurances Generales de Trieste et Venise," headquartered in Rome and of which the French branch is located in Paris, 9th Arondissement, 76 Rue Saint-Lazare, a refund of a portion of the corporation tax, amounting to FF 899,290, paid by it for the year 1977;

2. charge to the account of that branch the amount of corporation tax that had been refunded to it;

Given the other items produced and added to the file;

Given the constitution, notably Article 55 thereof;

Given the code Generales des Impots;

Given the code of the administrative courts;

Given the Franco-Italian tax treaty of October 29, 1958, its amendment of December 6, 1965, together with the order of December 23, 1958, the law of December 26, 1966, authorizing its ratification, and the decree of March 12, 1968, which assured its publication;

Given the order of July 31, 1945 and the decree of September 30, 1953;

Given the law of December 30, 1977;

After having heard the report of Mr. Turequet de Beauregard, Master of Requests, the observations of the SCP Martin-Martiniere, Ricard, attorney for the Assurances Generales de Trieste et Venise and the conclusions of Mr. Fouquet, Government Attorney.

Considering that the Minister of the Economy, of Finance and of the Budget requested the cancellation of the judgment by which the administrative court of Paris accorded the Generali-Assurances de Trieste et Venise, the French branch of the Italian company "Assicuruzione Generali," a refund of a portion of the corporation tax which that branch had paid for the year 1977, on dividends earned on its shareholdings in the capital of a French company "Generali-France," a shareholding which it is admitted satisfies the conditions fixed by Article 145 of the Code Generales des Impots; that, in that context, the Minister asserts that that branch, not being a French company and not being a juridical entity, is not eligible as to these dividends to benefit from the provisions of paragraph 4 of Article 22 bis of the Franco-Italian fiscal convention mentioned above, executed in Paris on October 29, 1985, or the tax regime applicable to parent companies defined in Articles 145 and 216 of Code Generales des Impots;

Considering that, under the terms of Paragraph 4 of Article 3 of the tax trety mentioned above, amended on December 6, 1965: "are considered to be permanent establishments. . .branches," and that under the terms of paragraph 4 of Article 22 bis of the same convention: "The taxation on a permanent establishment which an enterprise of a Contracting State has in the other contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities."

Considering that it clearly appears from the treaty that the branch in France of an Italian company, if it constitutes, as in this case, a permanent establishment within the meaning of the convention, must, even if it does not constitute a juridical entity by itself under French internal law, benefit from a tax regime that is not less favorable than that accorded to a French company; accordingly, the position of the French branch of the company "Assicurazione Generali," which is admitted to be a permanent establishment of that company, was well founded, as was found by the first judges, and was entitled to the tax regime of parent companies set forth in Articles 145 and 216 of the Code Generale des Impots;

Considering that it results from preceding text that the Minister of the Economy, of Finance and of the Budget is not correct in requesting the cancellation of the judgment attacked;

D E C I D E D :

Article 1: The appeal of the Minister of Economy, of Finance and of the Budget is rejected.

Article 2: Notification of the present decision shall be made to "Generali-Assurances Generales de Trieste et Venise" and to the Minister of the Economy, of Finance and of the Budget.